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Burundi: First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria— Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Burundi

In the context of the first review under the three-year arrangement under the Poverty Reduction and Growth Facility with Burundi, and request for a waiver of performance criteria, the following documents have been released and are included in this package:

- the staff report for the first review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for waiver of performance criteria, prepared by a staff team of the IMF, following discussions that ended on November 17, 2004, with the officials of Burundi on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 21, 2004. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of January 19, 2005 updating information on recent developments.
- a Press Release summarizing the views of the Executive Board as expressed during its January 19, 2005 discussion of the staff report that completed the request and review.
- a statement by the Executive Director for Burundi.

The documents listed below have been separately released.

Letter of Intent sent to the IMF by the authorities of Burundi*
Memorandum of Economic and Financial Policies by the authorities of Burundi*
Technical Memorandum of Understanding*

*Also included in the Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

BURUNDI

First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria

Prepared by the African Department
(In consultation with other Departments)

Approved by Juan Carlos Di Tata and Martin Fetherston

December 21, 2004

Arrangement: A three-year PRGF arrangement for SDR 69.30 million (90 percent of quota) was approved by the Executive Board on January 23, 2004. Burundi drew SDR 26.40 million (34.3 percent of quota) upon approval, of which SDR 19.25 million was used for the early repayment of the two drawings under the Fund's emergency post-conflict assistance policy. SDR 7.15 million (9.3 percent of quota) would be available upon completion of the first review.

Program discussions: Staff teams visited Bujumbura in August–September 2004 and November 2004 for discussions on the first review under the PRGF arrangement. Staff met with President Ndayizeye; newly appointed Vice-President Ngenzebuhoro; former Vice-President Kadege; State Minister for Good Governance, Privatization and State Inspection Nkurunziza; Minister of Finance Gahungu; Minister of Commerce and Industry Minani; and Central Bank Governor Toyi, as well as other senior officials. The staff also met with donors and representatives of the international community, including Ms. McAskie, special representative of the UN Secretary-General in Burundi.

Staff team: The staff team included Messrs. Mathieu (head), Lopes, Schulte (all AFR), and Dicks-Mireaux and Sdralevich (PDR). Mr. Nintunze, advisor to the Executive Director for Burundi and Messrs. Sow, Nelson, and Toto-Same of the World Bank also participated in the discussions.

Burundi continues to avail itself of the transitional arrangements under Article XIV of the Fund's Articles of Agreement, although it does not maintain any restrictions subject to Article XIV.

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EXECUTIVE SUMMARY

Within a difficult political environment, the Burundian authorities have started to implement the financial and structural reform program supported by the PRGF arrangement. Macroeconomic developments in 2004 have been broadly on track with program objectives. Real GDP growth will exceed the program target owing to a strong rebound in coffee production, and progress has been made in reducing inflation, notwithstanding the impact of surging world petroleum prices.

Performance relative to the program's quantitative and structural performance criteria has, however, been mixed. Fiscal slippages emerged following the surge in petroleum prices and higher spending needs associated with the peace process and the domestically financed counterpart to much higher-than-expected project spending. Significant transfers to cover continued coffee sector losses underscore the urgency of implementing the coffee reform strategy, which is also crucial to sustain the economic recovery. Structural reforms lagged somewhat, reflecting limited administrative capacity and the complex political environment, but the pace of implementation has intensified recently.

Important progress has been made in pursuing peace and reconciliation and initiating the multiyear demobilization effort and security (DDR/SSR) programs. The security situation has remained relatively calm and the political transition has gained momentum. The continued timely support of the international community is vital to ensuring a successful transition to democracy and to implementing the DDR/SSR effort without destabilizing public finances.

The program for 2005 includes several structural measures critical for successful macroeconomic stabilization and for moving toward the MDGs. These include reinforcing administrative capacity and public financial management, which remain weak by regional standards, strengthening monetary instruments and financial sector supervision, and further liberalizing the trade and exchange regimes.

Burundi has made considerable progress in normalizing relations with international creditors, including through a concessional flow rescheduling from Paris Club creditors and the clearance of remaining arrears to multilaterals. Nevertheless, the external debt burden remains unsustainable after traditional debt relief and will require substantial debt relief under the enhanced HIPC Initiative, as described in the preliminary HIPC document.

Notwithstanding the progress that has been made, large challenges remain. These include the need to complete the political transition to democracy, demobilize armed combatants, and address widespread deep poverty. In light of the progress achieved in 2004 in stabilizing the macroeconomic situation and pursuing structural reforms, the staff recommends the completion of the first review under the PRGF arrangement and supports the authorities' request for waivers for the nonobservance of an end-June quantitative performance criterion and two structural performance criteria.

I. INTRODUCTION

1. In a letter to the Managing Director dated December 20, 2004 and the accompanying Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU) (Appendix I), the Minister of Finance and the Governor of the Bank of the Republic of Burundi (BRB) request completion of the first review under the Poverty Reduction and Growth Facility (PRGF) arrangement and waivers for the nonobservance of the end-June 2004 quantitative performance criterion on external arrears and two structural performance criteria. Completion of the first review and disbursement of the second tranche of the arrangement would bring Burundi's use of Fund resources to 43.6 percent of quota (Table 1). Relations with the Fund, the World Bank, and the African Development Bank are summarized in Appendices II, III, and IV, respectively.

2. On the occasion of the request for a PRGF arrangement, which coincided with the Board discussion of the 2003 Article IV consultation, Directors commended Burundi for the progress made with the peace process and strong program implementation. They saw continued strengthening of economic and financial management as helping to ensure stability and provide a basis for mobilizing additional external support. Directors welcomed Burundi's intention to participate in the Enhanced Initiative for Heavily Indebted Poor Countries (HIPC) and considered that the decision point could be reached by the time of the second review under the PRGF. A preliminary HIPC Initiative Document, jointly prepared by the staffs of the Fund and World Bank, accompanies the request for completion of the first review.

II. RECENT DEVELOPMENTS

A. The Peace Process

3. **Burundi has reached a pivotal moment in the political transition process envisaged under the Arusha Peace Agreement of August 2000.** Following intensified political negotiations leading up to the end-October 2004 deadline for political transition under the Arusha Agreement, a new draft constitution and national elections were agreed upon. A national referendum on the draft constitution is scheduled for December 22, 2004. Hostilities in most of the country have ceased, but a small remaining hold-out rebel group continues to stage sporadic attacks in the periphery of Bujumbura that prevent the upgrading of the security situation. In May 2004, the United Nations Operations in Burundi (ONUB) assumed peacekeeping operations from the African Union. Key aspects of the political transition, new constitution, and elections are described in Box 1.

4. **Demobilization, disarmament, and reintegration (DDR) and security sector reform (SSR) operations began in earnest in late 2004.** The military integration and DDR/SSR programs are vital components for securing peace and security in Burundi. The operations are supported by the World Bank's Multi-Country Demobilization and Reinsertion Program (MDRP) for the Great-Lakes region and bilateral donors, in close

collaboration with ONUB. Demobilization operations formally began at end-November 2004. As of end-October, some 22,000 former rebel combatants had reported to cantonment centers (Box 2).

Box 1. Key Steps in Burundi's Peace and Reconciliation Process

- The Arusha Peace and Reconciliation Agreement was signed by 17 political parties in August 2000. A three-year transitional government was installed in November 2001. After 18 months, a presidential rotation occurred on April 30, 2002, in which Vice-President Domitien Ndayizeye (a Hutu) succeeded Major General Pierre Buyoya (a Tutsi). A cease-fire agreement was signed with several rebel groups in December 2002.
- In October 2003, a further breakthrough occurred with the signing of a protocol on security and power sharing with the largest rebel group, the CNDD-FDD. In November 2003, a broadened national unity government was installed. The transitional arrangements of the Arusha accord were to have ended on October 31, 2004 with a democratically elected government. In the event, the transition arrangements were extended through mid-2005 on the basis of an agreed draft constitution approved by parliament in October 2004, and a timetable for elections through April 2005. The extension of the transition arrangements was backed by regional heads of state that are supporting the peace process. In early November 2004, the main Tutsi party, UPRONA, which had been in power for much of the period since independence, ended its boycott of the new draft constitution.
- An independent national electoral commission was created in early September 2004. It has received funding from bilateral donors and technical and financial support from the UNDP.
- Preconditions for holding elections in early 2005 are the adoption of an electoral code and the constitutional referendum. The demobilization of former combatants and the formation of new defense forces are also viewed as necessary for a successful electoral process.
- The main provisions of the new constitution are:
 - (i) Direct election of the President, except for the first term, when the National Assembly will elect the President.
 - (ii) The President will appoint two Vice-Presidents representing the two main ethnic groups.
 - (iii) The National Assembly and council of ministers will be composed of Hutus (60 percent) and Tutsis (40 percent).
 - (iv) Representation in the Senate will be split equally between Hutus and Tutsis.

Box 2. Military Integration and the DDR and SSR Programs

The orderly disarmament and reinsertion into society of military personnel and ex-rebel combatants, as well as the creation of an integrated national defense force of appropriate size and composition, and an appropriately trained national police, are prerequisites for political stability, security, and a reduction in military expenditure. The first step in the process is the formal political and ethnic integration of Hutu rebel movements with the predominantly Tutsi-led army. The program is supported by the World Bank's MDRP.

Military integration and the SSR project aim at the creation of a National Defense Force (NDF) incorporating the existing army and ex-rebel groups. The project assumed 45,000 army personnel and 35,000 ex-rebel combatants. In late 2004, a census of the major groups led to a downward revision of the number for ex-rebel combatants to about 27,000 men. A new national police force is also being created to unify the existing four separate police forces and increase their number from 3,500 to 20,000. The increase in police will come primarily from the demobilized. The MDRP-supported DDR project is estimated to cost US\$84 million, and is being supported technically and financially by Belgium, France, the Netherlands, and the UK, in close collaboration with ONUB.

The four-year IDA-backed DDR program provides the framework to reduce the NDF from 80,000 to 25,000 by 2007. In this context, the DDR program supports direct demobilization of 20,000 government militiamen (*Guardiens de la paix*) and another 10,000 militant combatants (*combattants militants*) at the outset of the program. UNICEF is also supporting the demobilization and social reintegration of an estimated 8,000 child soldiers, of which some 2,300 had been processed by October 2004.

Burundi: Expenditure Projections for DDR, Military Integration, and National Police Force ^{1/}
(In millions of U.S. dollars, unless otherwise indicated)

Year	Military integration		DDR	Police integration	Total	Military spending	Military personnel	
	Recurrent	Capital				Recurrent		
							(in billions of F Bu)	
2003	...	...	...	...	...	45.4	45,000
2004	3.0	7.0	15.0	0.0	15.0	62.7	80,000	
2005	14.1	8.0	24.7	24.0	48.7	49.4	66,000	
2006	4.0	0.0	18.2	5.4	23.6	36.1	52,000	
2007	0.0	0.0	16.0	5.4	21.4	23.7	38,000	
2008	0.0	0.0	10.5	9.3	19.8			
Total	21.1	15.0	84.4	44.1	128.5			

1/ Staff estimates based on documentation from the authorities and IDA.

B. Performance Under the Program

5. **Macroeconomic performance has been broadly on track with program objectives, notwithstanding some slippages in fiscal policy.** Real economic growth is expected to be slightly above the program target of 5 percent in 2004, as activity has been bolstered by a larger-than-expected recovery of coffee production tempered by a decline in other basic agricultural products. Activity in the nonfarm sectors of the economy has remained buoyant and has benefited from the stepped-up presence of the donor community and peacekeeping troops. Annual inflation edged down through June to about 5½ percent but rebounded to about 10 percent in October. Inflation is now projected at about 8.5 percent by end-2004, somewhat

above the program target, reflecting higher petroleum prices and higher-than-programmed liquidity creation (Table 2 and Figure 1).

6. **Performance relative to the program's quantitative and structural performance criteria was mixed** (Appendix I, Tables 1 and 2, and Box 3). All the program's end-June quantitative performance criteria, except for that on external arrears, were observed. The beginning of period stock of external arrears ended-up being larger, and clearing operations slower, than expected, and the authorities have requested a waiver for the deviation from the end-June ceiling, as all nonreschedulable external arrears have since been cleared. The indicative ceilings on the government's wage bill and the primary fiscal deficit were exceeded, however, owing largely to the unanticipated need to include ex-rebel movements in the transitional government. Most of the program's end-September indicative targets were not met. On the structural front, the authorities have requested waivers for the nonobservance of two performance criteria—establishing an audit court (*Cour des Comptes*) and introducing domestic liquidity auctions—on which corrective actions have been taken. The two structural benchmarks consisting of extending the transactions tax to domestic goods and concluding an assessment of commercial banks' compliance with capital requirements were met.

Box 3. Structural Conditionality

Coverage of structural conditionality under the PRGF-supported program

Structural conditionality in 2004 aimed at achieving further progress in key areas, such as the liberalization of the exchange and trade system, the introduction of more efficient monetary policy instruments, including liquidity auctions, and the establishment of an audit court for public finances to improve governance and transparency (MEFP, Tables 2 and 4). For the second review under the 2005 PRGF-supported program, structural conditionality is aimed at further liberalizing the foreign exchange regime.

Status of structural conditionality under the 2004 program

The structural conditionality related to the establishment of an audit court (end-March) and improvements in monetary policy instruments (end-June) was not met, although several elements were completed. The introduction of liquidity auctions has been delayed owing to capacity constraints and the need for additional technical assistance. Fund assistance is being provided to allow for such auctions by Spring 2005. Regarding the audit court, the basic law was passed in March 2004, the Justices were named in June, financing was identified, and the internal regulations and office and equipment needs were put in place in autumn 2004. The court is expected to start operations by April 2005.

Structural areas covered by World Bank lending and conditionality

Under the World Bank's Economic Recovery Credit (ERC), approved in 2002, structural conditionality focused on the preparation of a strategic privatization plan, as well as an action plan for improving public finances and the operations and audit of the Treasury. Beginning in 2003, the government also linked budget allocations to the priorities identified in the I-PRSP and was required to monitor budget releases to such programs. For the release of the third and final tranche of the ERC (in December 2004), structural conditionality focused on the adoption of a reform strategy for the coffee and tea sectors, an action plan to eliminate gender disparities, a plan to reform public procurement, and the submission to parliament of legislation establishing an Office of Auditor General responsible for auditing the financial operations of public agencies.

7. **Fiscal pressures emerged early in 2004, and the primary balance moved into deficit (1.3 percent of GDP) during the first semester, compared with a surplus of 0.5 percent of GDP envisaged in the program** (Table 3).¹ The primary deficit deteriorated further to 3.1 percent of GDP by September. Revenues fell below the program's target—by 1.1 percent of GDP—as the partial pass-through of the sharp increase in world oil prices led to a shortfall in taxes from oil products and profit transfers from the central bank were smaller than expected. These shortfalls were offset in part by buoyant receipts from the income tax, reflecting strengthened tax administration. The overrun in primary spending stemmed from approximately equal overages in outlays needed to sustain the political transition and the peace process, payments of guaranteed coffee sector credit losses, and the domestically financed counterpart to much higher-than-expected project spending. Project spending, financed by concessional external support, doubled program expectations. Domestic arrears equivalent to 1.4 percent of GDP were paid off through end-September, including arrears to oil suppliers (which in turn settled their arrears with banks), but new outstanding payments orders of 1.4 percent of GDP were accumulated. The larger budget deficit, coupled with delays in the disbursement of external budget support, led to higher-than-programmed bank financing (MEFP, paragraph 8).

8. **A revised budget was signed into law in late September, following discussions with staff.** The revised budget targets a primary deficit of close to 3 percent of GDP in 2004, compared with a balanced position envisaged in the program. It provides for the extension of the import service charge to nondiplomatic imports and incorporates a 6 percent wage increase for civil servants (delayed from January). The revised budget also includes the hiring of 2,300 new teachers and 500 medical personnel to address existing shortages and progress toward the social objectives of the Poverty Reduction and Strategy Paper (PRSP).

9. **Monetary policy was under pressure in 2004 as a result of the higher financing needs of the government.** The larger deficit and delays in external budget support led to higher-than-envisaged net credit to government, which accounted for virtually all of the expansion in NDA of the BRB in the period through end-September (Table 4). The net foreign assets of the BRB dropped and gross official reserves declined to about 2.7 months of imports at end-September. To help contain liquidity growth, from mid-year the BRB tightened its ceilings on noncoffee credit to banks. Reserve money growth, which had risen rapidly in the first half of 2004, was stopped in the third quarter. Broad money growth (12-month change) decelerated to 14.5 percent in September (20 percent under the program), as banks accumulated excess reserves. Credit to the economy increased broadly in line with nominal GDP. Interest rates in the banking system remained broadly stable (see Table 2).

10. **During 2004, the Burundi franc remained broadly unchanged vis-à-vis the U.S. dollar, with the differential between the official and parallel exchange rates falling to about 2 percent, the lowest level in a decade** (Figure 2). The authorities consider the reduction

¹ The primary deficit targeted in the program is on a commitment basis before grants; it excludes spending on interest and special programs, such as elections, DDR/SSR operations, and foreign-financed project spending.

in the differential as a major accomplishment of their efforts at liberalizing the exchange system, including the reduction in foreign exchange surrender requirements and the admission of foreign exchange bureaus to the BRB's weekly foreign exchange auctions. However, they agree that further reforms are needed to improve the efficiency of the exchange regime. The real effective exchange rate depreciation slowed considerably in 2004, to about 4.3 percent through September.

11. **The external current account deficit is projected to widen sharply to 20.4 percent of GDP in 2004, reflecting a surge in imports fueled by NGO project activity, and the sharp rise in world oil prices** (Table 5). The export performance was better than expected in 2004, owing to a recovery in coffee production and world market prices. The overall balance of payments surplus is expected to be broadly in line with the program, as foreign assistance has exceeded expectations. Debt-service payments (after rescheduling and excluding repayment to the Fund of the post-conflict drawings) are projected to remain very high in 2004 at the equivalent of 83 percent of exports of goods and services.

12. **Burundi has made considerable progress in normalizing relations with international creditors, including through a concessional flow rescheduling from Paris Club creditors** (Box 4). The clearance of remaining arrears to multilaterals (the AfDB, the EU/EIB, and the OPEC Fund) was completed in the latter part of 2004.²

13. **The implementation of structural reforms has lagged somewhat, reflecting the complex political environment and weak administrative capacity** (Table 6). The coffee sector continues to face serious difficulties, reflecting large sectoral inefficiencies and weak world market prices. Production rose to about 38,000 tonnes in 2004, but processing constraints have led to delays in exports, higher inventory costs, and deterioration in quality. Cumulative losses since 2000/01 amount to over 2 percent of GDP, resulting in defaults on bank loans that have been covered by the budget under a government guarantee. The authorities recognized the need to liberalize the sector in order to attract much needed private investment and financing, improve quality, and bolster incomes of small producers, as well as to eliminate the fiscal burden. To this end, a comprehensive reform strategy developed with World Bank and EU support was approved by the council of ministers on October 28, 2004 (MEFP, paragraph 11).

14. **The establishment of an audit court, originally scheduled for end-March 2004 (performance criterion), is delayed.** While the audit court law was passed in March 2004 and its magistrates were appointed in June, a law to define the magistrates' legal status is still being considered by parliament. An action plan was approved by the council of ministers on October 28 to render the court operational by April 2005. Financing has been obtained and training and logistics are geared for the court to begin auditing the 2004 government accounts by the spring of 2005 (MEFP, paragraph 10).

² On October 27, the AfDB Board approved a plan to clear Burundi's arrears (US\$23 million) and restart lending operations. Arrears are to be cleared by the AfDB itself and donors (the EU and France) in equal proportions.

Box 4. Paris Club Rescheduling

Paris Club creditors agreed on March 4, 2004 to a restructuring of Burundi's public external debt, following the approval of a PRGF arrangement in January 2004. The deadline for concluding the bilateral agreements was extended from end-September 2004 to end-March 2005, and by November 2004 agreements had been signed with all but one creditor. The specifics are summarized below:

- The agreement treats both accumulated arrears as of end-2003 and current maturities falling due in 2004-06 under Naples terms.
- Pre-cutoff date (June 20, 1999 official development aid (ODA)) debts are rescheduled over 40 years, with 16-year grace period, at interest rates at least as favorable as the original interest rates.
- Pre-cutoff-date commercial credits are rescheduled over 23 years, with 8-year grace period, at market interest rates, with a present value reduction of 67 percent.
- 75 percent of interest accruing in 2005-06 on rescheduled amounts was capitalized, with repayment (in equal semi-annual installments) between September 2008 and March 2016.
- Creditors agreed to top-up the reduction rate to 90 percent (Cologne terms) as soon as Burundi has reached its decision point under the enhanced HIPC Initiative.
- Burundi committed to seek comparable treatment from other external creditors.

15. **Two of the three components of the end-June structural performance criterion on monetary management were implemented.** The BRB modified the rules governing the constitution of reserve requirements and the marginal refinancing rate for credit to banks, however, weekly liquidity auctions were not initiated owing to continued operational shortcomings.³ A recent MFD technical mission has made several recommendations to achieve further progress in this area and the BRB is working to enhance its liquidity forecasting capabilities and has adopted a plan to introduce weekly liquidity auctions and a rediscount facility by the spring of 2005. Prudential supervision was strengthened and two noncompliant banks were closed (MEFP, paragraphs 9 and 26).

III. POLICY DISCUSSIONS AND THE REVISED PROGRAM FOR 2004-05

A. Macroeconomic Objectives

16. **The authorities' objectives for the remainder of 2004 and 2005 are to consolidate the progress achieved on economic recovery and financial stability, address macroeconomic slippages, and deepen financial and structural reforms.** Discussions on the near-term focused on achieving a balance between containing inflation and increasing public spending to deal with

³ The level of required reserves was reduced from 8 to 5 percent of bank deposits in domestic currency; cash in vault can no longer be used to constitute required reserves. Reserves must meet the required minimum level averaged over a two-week period (reduced from four weeks). The central bank law was changed to provide for the remuneration of required reserves (initially at a rate of 5 percent).

the country's social priorities; providing adequate scope for private sector activity; and increasing international reserves from current levels.

17. **The updated program for 2004-05 aims to sustain growth at about 5 percent a year and reduce inflation to 8.5 percent by end-2004 and 5.5 percent by end-2005.** To support these goals while accommodating substantially higher expenditure levels, the overall fiscal deficit (on a cash basis after external grants) will be contained at 8.0 percent of GDP in 2004 and 6.4 percent in 2005, with the primary deficit targeted at 3 percent of GDP and 2 percent, respectively. The fiscal program will give priority to social spending; military and security expenditures (excluding DDR/SSR) will be restrained. The external current account deficit is expected to decline to 19.0 percent in 2005, reflecting much higher coffee exports. International reserves would rise from the equivalent of 4.3 months of imports at end-2004 to 5.8 months at end-2005.

18. **The authorities are committed to accelerating the implementation of structural reforms to support the economic recovery, ensure its sustainability, and reduce poverty.** Discussions focused on strengthening public financial management and fiscal transparency; improving the delivery of social services; enhancing monetary policy; and further liberalizing the trade and exchange regimes. The government is also pressing ahead with the political transition agenda and the DDR/SSR programs, which will help ensure a stable and secure environment for the development of the economy and improvements in social conditions.

B. Fiscal Policy

19. **The revised budget for 2004 aimed to maintain macroeconomic stability while accommodating unforeseen expenditure demands.** While the overall deficit before grants would be significantly larger than in the original program—owing to a sharp increase in external grants for projects, DDR/SSR, and the elections—the overall fiscal position (commitment basis, after grants) is projected to be in virtual balance, which represents a large improvement from the previous year. Revenues are cautiously projected at 19.4 percent of GDP in 2004, somewhat lower than originally envisaged, while expenditure would rise markedly owing largely to a sharp increase in project and special program spending.⁴

20. **In view of the slippages in 2004, fiscal policy in 2005 will be geared at avoiding a further significant erosion of revenues and containing expenditure** (MEFP, paragraphs 19-21). Total revenue is expected to decline somewhat to about 19 percent of GDP in 2005, reflecting the impact of an import duty reduction (0.3 percent of GDP)⁵ that will be offset, in part, by measures to contain customs exonerations and reduce tax evasion. Although primary

⁴ The higher primary deficit is partly matched by about 1.1 percent of GDP higher-than-programmed external budget grants.

⁵ The maximum tariff rate will be reduced from 40 percent to 30 percent and the 12 percent tariff will be folded into the 10 percent rate, for a reduction in the number of tariff bands to three.

expenditures excluding special programs would be reduced, total expenditures will remain high, owing to large-scale external assistance to accommodate reconstruction and transitory electoral and DDR/SSR costs. Social sector spending is budgeted at 7 percent of GDP in 2005 (6.7 percent in 2004), while military spending would decline by about ½ percentage point of GDP to 6.3 percent of GDP.⁶ Budget support (grants and loans) from multilaterals is expected to rise sharply in 2005, while bilateral grant assistance would decline. Privatization receipts are projected at about 0.6 percent of GDP in 2005, reflecting the start of a national privatization program.⁷ A remaining financing gap of about US\$28 million is expected to be covered by bilateral grants. This level of concessional financing would allow for a reduction in domestic arrears and the government's net indebtedness to the banking system. In late December, the government submitted to parliament a draft budget consistent with the abovementioned objectives.

21. **The authorities are committed to improving the management of public finances, with technical and financial support from key donors, including the World Bank** (MEFP, paragraphs 23-24). The inventory of domestic arrears is an important initial step in the authorities' objective of normalizing relations with suppliers and lifting the burden of unpaid bills on the private sector, including the banking system. An arrears clearance strategy will be defined in the context of the second program review.

C. Monetary, Financial Sector, and Exchange Rate Policies

22. **Pressure on monetary policy resulting from delayed budget support and higher-than-expected government spending is expected to ease in late 2004 with the disbursement of delayed budget support from the EU and the World Bank.** Broad money growth is projected to be slightly above the program, at about 19 percent by year's end. Reserve money growth would decline from a midyear high to about 27 percent by end-2004, owing to the reduction in credit to government and to banks.

23. **The program for 2005 aims to lower broad money growth to 15 percent in order to achieve the envisaged decline in inflation.** Reserve money growth would decline to below 10 percent owing to a reduction in net credit to government and a significantly lower expansion of coffee credit. Assuming a slight decline in velocity, the fiscal program would allow credit to the private sector to grow somewhat more than nominal GDP.

24. **Monetary management will be reinforced in 2005 through the migration from bank-by-bank administrative credit ceilings to a more effective market-determined overall**

⁶ Budgeted social spending does not take into account possible increases subsequent to possible debt relief under the enhanced HIPC Initiative from mid-2005. The costs of DDR/SSR operations are not included in military spending. The latter does however include temporary increases in military costs (such as payroll and food) associated with the process of integrating former rebel combatants into the army before they are demobilized.

⁷ Any amounts received above this amount will be used to reduce domestic debt.

liquidity management system. To this end, in January 2005 the BRB will unify and cut further its credit ceilings (which are still nonbinding) and in the spring of 2005 it will introduce weekly liquidity auctions with technical support from MFD. In addition, treasury bills are to be standardized and made tradable.

25. **Overall, Burundi's financial sector remains generally sound, although some small banks appear vulnerable.** Following the strengthening of minimum capital requirements (nearly tripled) in March 2004, the BRB is making further efforts to improve bank supervision and gradually tighten prudential requirements in line with international standards. The BRB is also committed to improving transparency and has signed a multiyear external audit contract.

26. **The authorities are committed to pursuing further exchange system liberalization** (MEFP, paragraph 28). In support of a move to an interbank exchange market regime, the remaining export surrender requirement (50 percent on coffee, tea, and cotton) will be abolished by March 2005 (performance criterion). With the support of Fund technical assistance, the restrictions and reporting requirements on foreign exchange transactions will be further simplified in 2005.

D. Structural Reforms

27. **In addition to the measures in the areas of public financial management, tariff reform, and exchange liberalization, other important reforms include the liberalization of key productive sectors and improvements in governance** (MEFP, paragraphs 29-32).

28. **The government is putting in place the recently approved reform strategy for the coffee sector, which was prepared with technical support from the EU and the World Bank.**⁸ A first step was taken in December 2004 by allowing private investment at all levels of the supply chain. The restrictions on the export and sale of coffee will be abolished in early 2005 (once existing crop credit is repaid), and government holdings in the coffee processing infrastructure will be offered for sale by June 2005. Subsequently, the state marketing monopoly, OCIBU, will be restructured and converted into a regulatory and support agency. In 2005, the government also intends to liberalize the sugar sector, which remains highly regulated and distorted.

29. **A well functioning audit court is essential for improving the transparency and accountability of the public finances.** As noted above, the government has undertaken, in conjunction with parliament, several measures to ensure that the court is fully operational by April 2005 (MEFP, paragraph 32). The last major hurdle to the court's establishment is expected to be overcome in December with the passage of the necessary legislation on the statutes of the magistrates.

⁸ The reform also comprises the tea and cotton sectors.

E. Program Financing

30. **For 2005, the overall external nonproject financing need is estimated at US\$190 million** (Table 7). This requirement is expected to be covered, to a large extent, by financial assistance from the World Bank (ERC2 credit), the AfDB, the EU, and bilateral donors. In addition, funding has been secured for the constitutional referendum in late 2004 and the national elections in 2005, largely in the form of bilateral grants. A residual gap of US\$28 million (3.8 percent of GDP) corresponding to remaining budgetary financing needs associated with the DDR/SSR program, is expected to be closed at a donors meeting tentatively scheduled for the spring of 2005.⁹ In the circumstances, Burundi should be able to meet, without difficulty, its external nonreschedulable debt-service payments.

31. **Burundi's external debt service burden remains unsustainably high, even after traditional debt relief.** A preliminary debt sustainability analysis prepared by Fund and World Bank staffs indicates an external debt-to-exports ratio, on a present value basis, of above 1,800 percent at end-2003 (after Paris Club Naples flow relief). Thus, substantial relief under the enhanced HIPC Initiative will be needed to restore debt sustainability.

F. Program Monitoring

32. **The program's prior actions, quantitative performance criteria (end-December 2004 and end-June 2005), indicative targets, and structural performance criteria are listed in Tables 3 and 4 of the MEFP.** In the context of the coffee sector reform, the authorities agreed that any new credit guarantee granted during the transitory period 2005/06 would be consulted with Fund staff. The definitions of the program's performance targets, external assistance adjustors, and underlying assumptions, as well as Burundi's reporting requirements, are set out in the TMU (annexed to the MEFP). The nonproject external financing adjustor and the definition of external arrears have been modified (MEFP, Table 4, and TMU).

33. **The authorities indicated that nonobservance of the program's two structural performance criteria was attributable to the complex political environment and weak administrative capacity.** They noted that corrective actions for both structural measures were now in process. As noted above, the June 2004 ceiling on the stock of external arrears was exceeded because of an upward revision of the stock estimated at the time the 2004 program was designed and slower-than-expected clearing operations. Nonreschedulable arrears have now all been cleared and negotiations are continuing with non-Paris Club creditors (MEFP, paragraphs 26, 32, and 36).

34. **Completion of the second review is scheduled for May 2005, and will be conditional upon the observance of the quantitative performance criteria at end-December 2004 and the end-March 2005 structural performance criterion** (Table 8). During the review mission,

⁹ The residual financing gap does not take into account the impact of possible debt relief under the enhanced HIPC Initiative.

the staff will discuss priority budgetary expenditures that could be accommodated in the event higher-than-programmed external concessional funding becomes available. Completion of the second review forms the basis for reaching the Decision Point under the enhanced HIPC Initiative. It is important that the full PRSP be prepared in a timely manner and on a fully participatory basis.

IV. MEDIUM-TERM OUTLOOK AND CAPACITY TO REPAY THE FUND

35. **Burundi's external position is expected to improve over the medium term with the recovery of economic activity.** Over the short term, however, the external current account deficit (excluding official grants) is expected to remain large, reflecting the post-conflict hump in reconstruction activity. Starting in 2006, the deficit would follow a declining path to about 15 percent of GDP by 2010 (Table 9). Financing these deficits would require substantial external grants and loans on highly concessional terms through the medium term.

36. **The medium-term external position is vulnerable to fluctuations in the terms of trade, as shown in the sensitivity scenarios presented in Table 9.** At the same time, the coffee-price scenario underscores how a stronger-than-envisaged improvement in coffee quality and marketing under the coffee sector reform could translate into higher coffee export earnings. Burundi's capacity to repay the Fund remains broadly as described in the staff report for Burundi's request for the PRGF arrangement.

V. SAFEGUARDS, TECHNICAL ASSISTANCE, AND PROGRAM RISKS

37. **The Fund's Finance Department has initiated a safeguards assessment of the BRB.** In view of constrained administrative and technical capacity, a two-step approach was adopted. The first stage, which was successfully completed in June 2004, involved an assessment of the areas considered critical to preventing the possibility of misreporting and safeguarding Fund resources, notably, the BRB's external audit mechanism, financial reporting framework, and the system of internal controls. A second stage, which is expected in 2005, will evaluate the BRB's legal framework and internal audit mechanism. In line with the staff recommendations under the first stage, the BRB is acting to improve its financial reporting mechanisms and strengthen its system of internal controls. Following the appointment of an audit firm of international reputation, work began in November 2004 on the BRB's first external audit.

38. **Burundi has extensive technical assistance needs** and the authorities will continue to work closely with multilateral and bilateral partners to rebuild administrative capacity in priority areas. Efforts will be undertaken to improve the national statistical base following the recommendations of an IMF multi-sector statistics mission in November/December 2004.

39. **The program faces a number of risks, especially with respect to regional tensions and the internal political and security situation.** In particular, the political transition could be undermined by failure to proceed expeditiously with military demobilization. In turn, without adequate and timely support for the DDR/SSR process, the fiscal and macroeconomic accounts could be destabilized. Overall, these risks appear contained in view of the commitment of the

international community to accompany the peace process and the progress made so far in these sensitive areas.

VI. STAFF APPRAISAL

40. **Within a difficult political environment, the Burundi authorities have made a credible start to implement the financial and structural reform program supported by the PRGF arrangement.** Macroeconomic developments in 2004 have been broadly on track with program objectives. Real GDP growth will exceed the program target owing to a strong rebound in coffee production, and progress has been made in reducing inflation, notwithstanding the impact of surging world petroleum prices.
41. **Performance relative to the program's quantitative and structural performance criteria, however, has been mixed.** Fiscal slippages emerged in 2004 following the surge in petroleum prices and higher spending needs associated with the peace process. The staff is of the view that the relaxation of the fiscal target was appropriate in light of the need to accommodate priority expenditures. Significant transfers to cover continued coffee sector losses underscore the urgency of implementing the coffee reform strategy without delay. Structural reforms lagged somewhat, reflecting limited administrative capacity and the complex political environment, but the pace of implementation has intensified recently. The large increase in highly concessional donor support for project spending was a welcome development.
42. **Important progress has been made in pursuing peace and reconciliation.** The security situation has remained relatively calm and the political transition has gained momentum. The continued support of the international community is vital to ensuring a successful transition to democracy. The staff stresses the importance of Burundi completing the full PRSP in a timely manner and on a fully participatory basis.
43. **Significant progress has also been achieved in setting the groundwork for the multiyear demobilization effort and the creation of a suitably trained national police force.** It is important that the costs associated with these programs, which are large in relation to GDP, be contained at approved levels and carefully monitored. Appropriate and timely donor support is vital to ensure that the DDR/SSR effort moves ahead without destabilizing the public finances.
44. **The 2005 budget appropriately incorporates a reduction in the primary deficit before grants and targets a further increase in social spending.** Every effort should be made to achieve the revenue target of 19 percent of GDP, particularly taking into account the envisaged reduction in trade taxes. Regarding expenditure, it is important that the savings arising from the demobilization program be effectively secured and redirected to urgent social needs.
45. **The 2005 budget includes measures to strengthen administrative capacity and public financial management, which remain weak by regional standards.** In particular, it is essential to move ahead with the new budget and accounts code, reinforce tax and customs administration, and strengthen the Ministry of Finance's operations, including wage bill management.

46. **Initial steps to strengthen monetary policy were taken in 2004, albeit with delays reflecting administrative shortcomings.** Looking ahead, the BRB should strengthen its monetary instruments and implement vigorously the recommendations made by Fund technical assistance missions. In addition, it should remain vigilant in its supervision of the banking sector, building on the improvements made in 2004. Recent steps to address the weaknesses identified in the context of the initial safeguards assessment, notably the initiation of the first external audit, are welcome. The staff is of the view that progress in this area provides a sufficient basis to complete the first review, notwithstanding that only a partial safeguards assessment has been conducted.

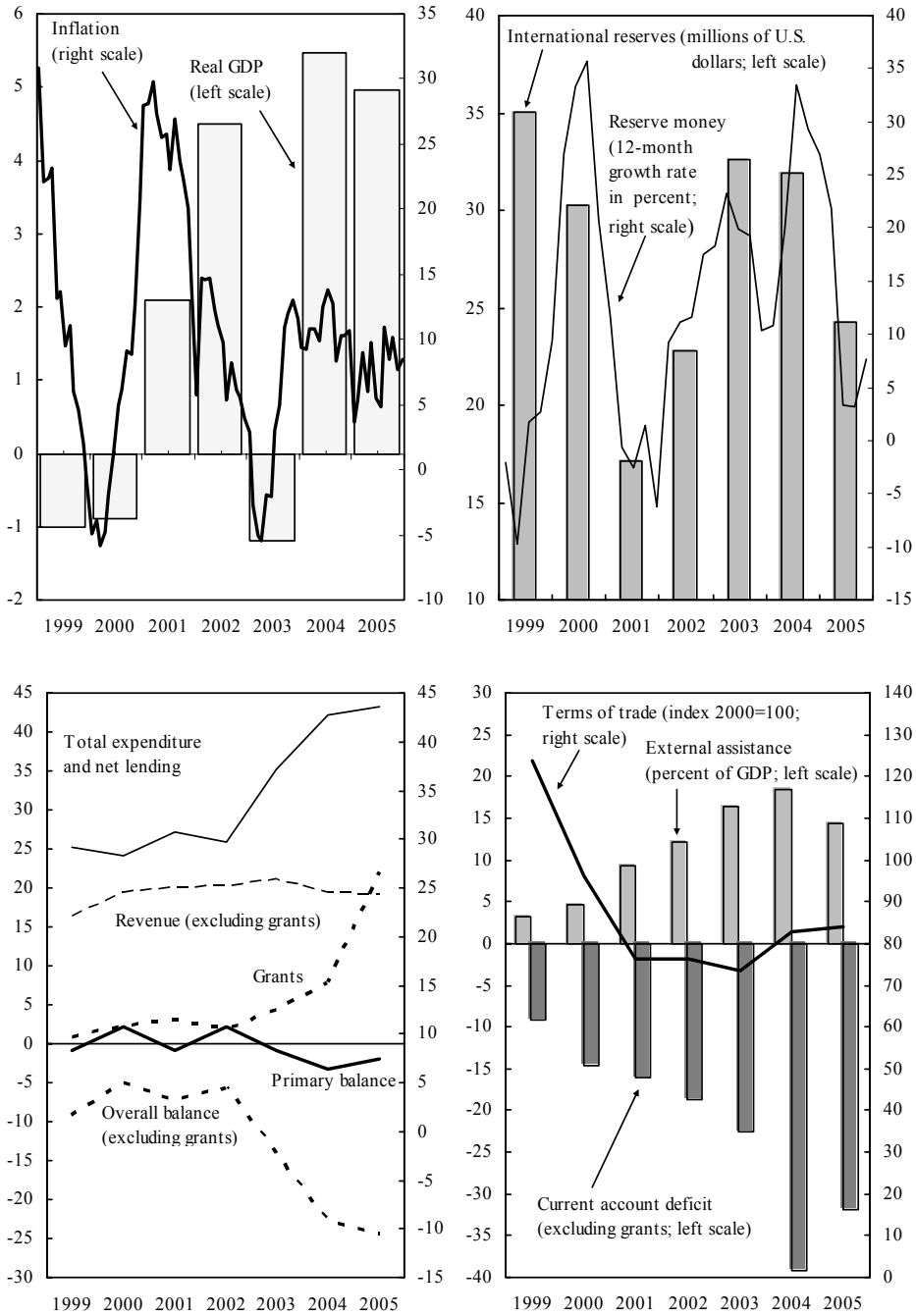
47. **The reduction in the differential between the official and parallel exchange rates to low levels by the fall of 2004 is an encouraging development.** The authorities should proceed decisively with the steps envisaged in early 2005 to further liberalize the exchange and trade systems.

48. **On the structural front, rapid implementation of the coffee sector reform program is crucial to sustain the economic recovery and reduce pressures on the public finances.** Efforts should also be intensified to open the audit court and begin the privatization of state assets.

49. **The staff welcomes the progress made in normalizing relations with external creditors.** The clearing of Burundi's arrears with the AfDB through a cooperative effort with donors, and the restarting of AfDB lending operations, are noteworthy in this respect. Burundi's external debt burden remains unsustainable after traditional debt relief and will require substantial debt relief under the enhanced HIPC Initiative, as described in the preliminary HIPC document.

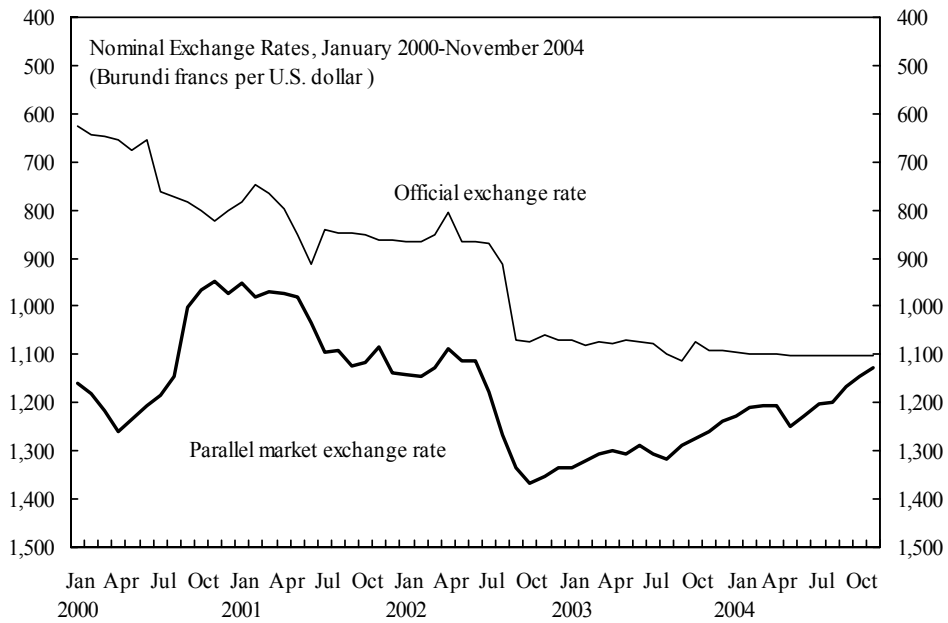
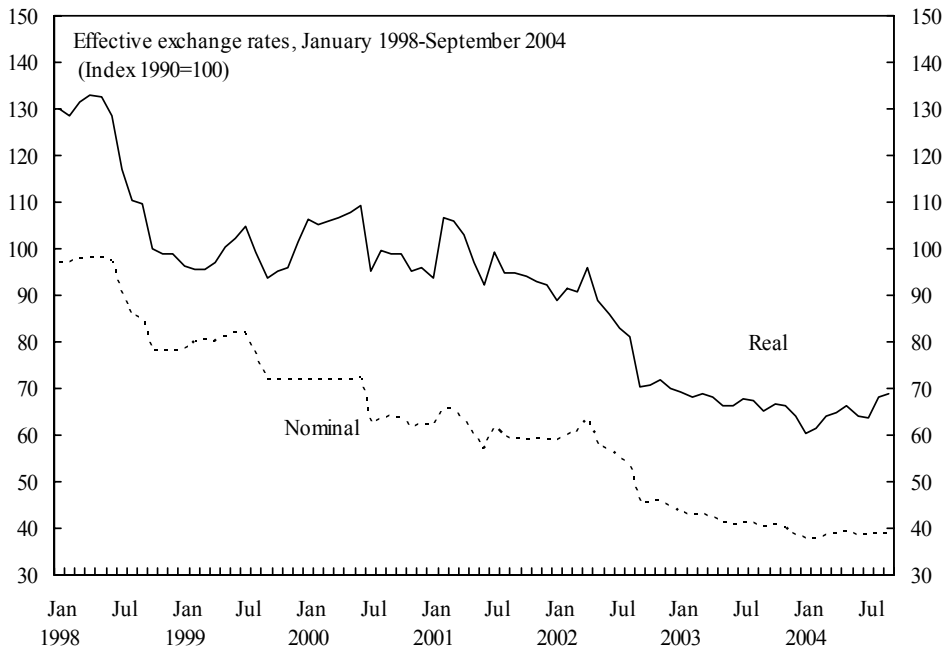
50. **Burundi still faces enormous challenges, including the need to complete the political transition to democracy, demobilize large numbers of armed combatants, and address widespread deep poverty.** In light of the progress achieved in 2004 in stabilizing the macroeconomic situation and pursuing structural reforms, the staff recommends the completion of the first review under the PRGF arrangement and supports the authorities' request for waivers for the nonobservance of an end-June 2004 quantitative performance criterion and two structural performance criteria, noting that corrective actions have been taken.

Figure 1. Burundi: Economic and Financial Indicators 1999-2005



Sources: Burundi authorities; and Fund staff estimates and projections.

Figure 2. Burundi: Exchange Rate Developments
(Monthly averages)



Sources: Burundi authorities; and IMF, Information Notice System.

Table 1. Burundi: Projected Payments Obligations to the Fund and Indicators of Fund Credit, 2004-08

(In millions of SDRs, except where indicated otherwise)

	2004		2005				2006	2007	2008	Total 2004-08
	Actual	Jan-Mar.	Apr-June	July-Sep.	Oct-Dec.	Projected				
Projected payments under existing PRGF disbursements and SDR charges										
PRGF principal repayments		0.07	0.14	0.07	0.14	0.41	0.41	0.41	1.65	
Interest/charges	0.34	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
SDR periodic charges	0.27	0.07	0.14	0.07	0.14	0.41	0.41	0.41	1.99	
PRGF interest repayments	0.07	0.00	0.07	0.00	0.07	0.28	0.28	0.28	1.40	
Projected payments under prospective PRGF disbursements		0.00	0.00	0.00	0.00	0.13	0.13	0.13	0.59	
Principal		0.00	0.00	0.05	0.00	0.05	0.21	0.21	0.62	
Interest/charges		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
		0.00	0.00	0.05	0.00	0.05	0.21	0.21	0.62	
Total projected payments										
Principal		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Interest/charges		0.07	0.14	0.12	0.14	0.47	0.63	0.63	2.27	
SDR periodic charges		0.07	0.07	0.07	0.07	0.28	0.28	0.28	1.13	
PRGF		0.00	0.07	0.05	0.07	0.19	0.34	0.35	1.15	
Total projected payments		0.07	0.14	0.12	0.14	0.47	0.63	0.63	2.27	
In millions of SDRs		0.15	0.28	0.26	0.28	0.97	0.97	0.87	3.87	
In percent of exports of goods and service credits		0.09	0.18	0.16	0.18	0.61	0.82	0.79	2.79	
In percent of gross international reserves										
Outstanding IMF credit (end of period)										
In millions of SDRs	26.40	33.55	40.70	40.70	47.85	47.85	69.30	69.30	...	
In millions of U.S.dollars	39.60	50.33	61.05	61.05	71.78	71.78	103.26	103.26	...	
In percent of quota	34.29	43.57	52.86	52.86	62.14	62.14	90.00	90.00	...	
In percent of exports of goods and service credits	77.45	69.42	84.21	84.21	99.00	99.00	110.40	107.62	95.71	
In percent of gross international reserves	48.45	43.76	53.09	53.09	62.41	62.41	83.04	90.64	87.42	
Memorandum items:										
Repayments of GRA resources (drawn as emergency post-conflict assistance)	19.25									
Actual/projected PRGF disbursements	26.40	7.15	7.15	0.00	7.15	21.45	7.15	0.00	69.30	
Exports of goods and services credits (in millions of U.S. dollars)	51.13	72.50	72.50	72.50	72.50	72.50	83.88	107.89	...	
Gross official reserves (in millions of U.S. dollars)	81.73	115.00	115.00	115.00	115.00	115.00	113.92	118.12	...	

Source: IMF, Finance Department.

Table 2. Burundi: Selected Economic and Financial Indicators, 2002-07

	2002	2003		2004		2005 Proj.	2006 Proj.	2007 Proj.
		Prog.	Actual	Prog.	Proj.			
(Annual percentage change, unless otherwise indicated)								
National income and prices								
Real GDP growth	4.5	1.1	-1.2	5.1	5.5	5.0	5.0	5.0
GDP deflator	1.7	10.4	11.6	6.7	8.0	6.7	6.0	5.8
Consumer prices (period average)	-1.3	9.9	10.7	6.4	7.5	6.6	5.3	5.1
Consumer prices (end of period)	3.5	7.5	10.7	5.5	8.5	5.5	5.2	5.0
External sector								
Exports, f.o.b. (in U.S. dollars)	-20.3	63.1	28.6	-30.1	9.4	39.1	15.7	14.3
Imports, f.o.b. (in U.S. dollars)	-4.2	12.5	29.0	9.9	44.9	6.2	-6.9	2.2
Export volume	-19.7	55.7	30.3	-33.8	-18.2	39.2	9.4	7.0
Import volume	-3.4	5.3	25.7	9.1	30.9	6.5	-6.7	2.0
Terms of trade (deterioration -)	-0.1	-1.9	-3.8	4.8	20.9	0.1	6.0	6.7
Real effective exchange rate (annual average; depreciation -)	-15.1	...	-18.6	...	-4.3 1/	...	...	...
Central government								
Revenue	7.5	6.0	14.9	9.8	4.9	9.7	11.9	11.3
Total expenditure and net lending (commitment basis)	1.1	28.8	50.1	10.3	36.4	15.0	-6.5	0.5
Noninterest current expenditure	0.7	12.9	15.9	3.8	22.7	2.0	13.8	11.7
(Change in percent of beginning-of-period M2, unless otherwise indicated)								
Money and credit								
Net foreign assets	7.1	-4.1	19.0	-1.9	-7.7	2.8	2.8	0.9
Domestic credit	24.0	36.9	14.0	20.8	30.6	11.6	7.6	9.5
Government	-10.2	17.2	9.6	9.2	18.9	-4.9	-2.5	0.0
Private sector	34.0	15.2	5.5	15.3	13.8	16.4	10.4	9.8
Money and quasi money (M2)	27.2	14.0	23.1	18.3	18.6	14.9	16.5	15.0
Income velocity (ratio of GDP to M2; end of period)	4.1	3.6	3.7	3.6	3.6	3.5	3.3	3.2
Reserve money (12-month growth rate)	23.2	14.3	10.9	14.3	26.9	7.7	12.9	12.4
Central bank refinancing rate (in percent; end of period)	15.5	15.5	14.5	...	14.5 2/	...	...	...
Commercial bank lending rate (in percent; medium term; period average)	20.6	19.6	20.7	...	20.5 1/	...	...	...
(In percent of GDP)								
Central government								
Revenue (excluding grants)	20.3	19.4	21.1	19.7	19.4	19.0	19.1	19.2
Total expenditure and net lending	25.9	29.5	35.3	29.5	42.2	43.4	36.4	33.0
Primary budget balance (excluding foreign-financed projects)	2.2	-1.5	-0.8	0.0	-3.2	-1.9	-1.9	-1.7
Overall balance (commitment basis)								
Excluding grants	-5.7	-10.1	-14.2	-9.8	-22.8	-24.3	-17.3	-13.8
Including grants	-1.4	-7.3	-6.3	...	0.3	-3.6	-4.4	-4.0
Savings-investment balances								
Current account balance (excluding capital grants)	-6.5	-8.1	-6.1	-9.3	-20.4	-19.0	-15.1	-14.5
Gross investment	5.2	11.7	10.4	11.7	12.4	12.8	12.7	13.0
Public	3.6	8.7	8.3	8.7	9.4	9.4	8.7	8.7
Private	1.6	3.0	2.1	3.0	3.0	3.3	4.0	4.3
Gross national savings	-1.3	3.6	4.2	2.4	-7.9	-6.2	-2.4	-1.4
Public	-0.2	-1.8	-1.3	-1.4	-4.4	-2.5	-2.4	-2.4
Private	-1.1	5.3	5.5	3.7	-3.5	-3.7	0.0	0.9
(In millions of U.S. dollars, unless otherwise indicated)								
External sector								
Current account	-40.7	-48.3	-36.5	-60.1	-135.9	-148.0	-129.9	-133.5
Overall balance of payments	-27.1	-63.2	-11.9	22.4	25.4	-27.0	-28.4	-20.5
Gross official reserves (end of period)	60.1	52.9	68.9	87.9	81.7	115.0	111.5	113.9
Gross official reserves (in months of imports, c.i.f.)	5.9	4.6	5.3	6.5	4.3	5.8	6.0	6.0
Net official reserves (in months of imports, c.i.f.)	2.2	3.1	2.5	2.2	1.7	1.6	2.0	2.0
Debt-service ratio (scheduled; in percent of export and service receipts)	121.7	96.8	108.3	193.9	146.0	62.4	54.9	45.8
External payments arrears	181.1	...	176.8	...	...	...	...	...
Memorandum items:								
Exchange rate (Burundi francs per U.S. dollar; average)	931	1,074	1,083	1,120	1,101 2/	...	...	...
GDP at current market prices (in billions of Burundi francs)	584.6	647.4	644.7	722.5	734.3	822.5	915.1	1,015.9

Sources: Burundi authorities; and Fund staff estimates and projections.

1/ Data through September 2004.

2/ Data through November 15, 2004.

Table 3. Burundi: Central Government Operations, 2003-05

	2003		2004				2005				
	Act.	Jan.-Jun.		Jan.-Sep.		Jan.-Dec.		Jan.-Mar.	Jan.-Jun.	Jan.-Sep.	Jan.-Dec.
		Prog.	Act.	Prog.	Act.	Prog.	Proj.				
	(In billions of Burundi francs)										
Revenue	136.0	73.3	69.3	113.6	107.2	142.4	142.6	43.3	81.0	118.0	156.4
Tax revenue	120.5	62.5	60.9	99.9	96.0	128.6	128.9	35.5	71.0	106.5	142.0
Income tax	32.4	14.3	16.6	20.8	24.5	29.1	32.0	8.7	17.5	26.2	35.0
Taxes on goods and services	58.4	31.2	30.3	49.4	49.5	63.9	65.3	18.4	36.7	55.1	73.5
Taxes on international trade	29.5	16.9	13.7	29.6	21.8	35.4	31.0	8.2	16.4	24.7	32.9
Other tax revenue	0.3	0.1	0.3	0.1	0.3	0.2	0.6	0.2	0.3	0.5	0.7
Nontax revenue	15.5	10.8	8.4	13.6	11.2	13.7	13.7	7.8	10.0	11.5	14.4
Expenditure and net lending	227.3	96.0	141.8	144.8	231.0	213.1	310.1	91.8	180.9	269.3	356.6
Current expenditure	144.3	75.8	82.4	111.2	131.3	152.2	175.1	44.7	88.6	133.0	176.9
Salaries	53.8	28.5	30.2	42.0	44.6	58.4	61.8	16.3	32.6	48.9	65.2
Civilian	30.8	16.0	18.1	23.7	26.5	33.1	36.5	10.0	20.1	30.1	40.1
Military	23.0	12.5	12.1	18.4	18.0	25.3	25.3	6.3	12.5	18.8	25.1
Goods and services	47.3	26.0	26.4	37.3	43.5	45.8	54.7	13.7	27.3	41.0	54.6
Civilian	23.4	12.8	15.3	17.8	22.1	23.4	29.7	7.0	14.0	20.9	27.9
Military	24.0	13.2	11.1	19.5	21.5	22.4	25.0	6.7	13.4	20.0	26.7
Transfers and subsidies	15.8	7.6	10.0	10.7	21.5	19.1	27.0	6.6	13.3	19.9	26.5
<i>Of which</i> : to coffee sector	5.4	...	1.5	...	7.6	1.5	7.6	0.0	0.0	0.0	4.0
Interest payments (due)	27.4	13.7	15.8	21.2	21.7	29.0	31.7	8.2	15.4	23.3	30.6
Domestic	13.3	7.8	9.6	11.0	10.9	14.3	17.6	4.9	9.8	14.6	19.5
Foreign	14.1	5.9	6.2	10.1	10.8	14.8	14.1	3.3	5.7	8.7	11.1
DDR and SSR project /1							17.6	12.0	27.0	42.0	55.0
Elections 1/							9.3	10.0	16.1	16.1	16.1
Project expenditure	85.0	20.6	59.8	34.8	100.4	62.9	110.1	25.5	50.3	79.6	110.6
Domestic resources 2/	26.5	7.7	12.6	15.3	21.2	21.0	25.0	6.9	13.8	20.6	27.5
External resources	58.4	12.9	47.2	19.5	79.2	41.9	85.1	18.7	36.5	59.0	83.1
Net lending	-2.0	-0.4	-0.4	-1.2	-0.7	-2.0	-2.0	-0.5	-1.0	-1.5	-2.0
Overall balance (commitment basis)	-91.3	-22.8	-72.4	-31.2	-123.8	-70.7	-167.4	-48.5	-99.9	-151.3	-200.2
(after grants)	-40.5	40.1	-21.8	31.6	-12.2	16.7	2.4 #	-18.0	-19.3	-46.2	-29.4
<i>Of which</i> : primary balance 3/	-5.4	3.9	-9.5	9.4	-22.9	0.1	-23.8	0.4	-4.9	-10.8	-15.3
Change in arrears (reduction -)	-2.2	-37.3	-25.9	-37.3	-39.8	-37.3	-61.4	-9.2	-10.2	-11.2	-23.2
External (interest)	4.2	-32.8	-30.6	-32.8	-39.7	-32.8	-49.5	-8.2	-8.2	-8.2	-8.2
Domestic	-6.4	-4.5	4.7	-4.5	-0.1	-4.5	-11.9	-1.0	-2.0	-3.0	-15.0
Overall balance (cash basis)	-93.5	-60.1	-98.3	-68.5	-163.6	-108.0	-228.8	-57.6	-110.1	-162.4	-223.3
(after grants)	-42.6	2.8	-47.7	-5.7	-52.0	-20.6	-59.1	-27.1	-29.5	-57.3	-52.5

Table 4. Burundi: Monetary Survey and Central Bank Accounts, 2003-05

	2003		2004				2005					
	December		June		September		December		March	June	Sept.	Dec.
	Proj.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Rev. Prog.	Prog.	Prog.	Prog.	Prog.
(In billions of Burundi francs)												
Monetary survey												
Net foreign assets	46.8	45.2	42.2	8.2	34.7	-3.4	38.3	31.8	27.5	18.9	17.3	37.6
Central bank	39.3	35.6	36.5	12.4	29.9	0.6	34.3	35.1	24.7	15.9	14.0	34.1
Deposit money banks	7.5	9.6	5.8	-4.2	4.9	-4.0	4.0	-3.3	2.8	3.0	3.3	3.5
Net domestic assets	130.2	128.5	146.2	171.3	159.5	188.2	161.7	174.3	173.1	189.0	195.9	199.2
Domestic credit	198.0	215.0	210.0	249.6	219.4	275.9	226.6	267.9	258.5	276.6	285.7	291.7
Net claims on the government	34.5	46.1	39.6	71.7	45.5	93.5	49.2	78.1	82.2	81.3	88.5	68.6
Central government	42.0	56.4	47.2	80.8	53.2	103.6	57.0	89.3	93.3	94.3	99.3	79.3
Other government (deposits)	-7.5	-10.3	-7.7	-9.1	-7.7	-10.1	-7.8	-11.2	-11.1	-11.0	-10.8	-10.7
Credit to the economy	163.4	168.9	170.5	177.9	174.0	182.3	177.4	189.8	176.2	195.3	197.2	223.1
Claims on public enterprises	4.2	7.0	4.1	5.3	4.1	6.6	4.0	4.0	3.9	3.7	3.6	3.4
Claims on private sector	159.3	162.0	166.4	172.6	169.9	175.7	173.4	185.8	172.4	191.6	193.7	219.7
Other items, net (assets +)	-67.8	-86.5	-63.8	-78.3	-59.9	-87.7	-64.9	-93.7	-85.3	-87.6	-89.8	-92.6
Money and quasi money	177.0	173.7	188.5	179.5	194.2	184.8	200.0	206.1	200.6	208.0	213.1	236.8
Money	116.5	120.6	124.1	132.8	127.9	138.3	131.7	153.2	148.3	155.7	157.6	174.6
Currency in circulation	51.5	44.5	54.8	56.4	56.5	54.6	58.2	58.0	54.3	61.7	57.7	62.9
Demand deposits	65.0	76.1	69.3	76.4	71.4	83.7	73.5	95.2	94.0	94.0	99.9	111.8
Quasi money	60.4	53.1	64.4	46.7	66.3	46.5	68.3	52.9	52.3	52.3	55.5	62.1
Central bank												
Net foreign assets	39.3	35.6	36.5	12.4	29.9	0.6	34.3	35.1	24.7	15.9	14.0	34.1
Foreign assets	79.3	75.3	90.2	84.3	95.7	55.4	101.1	89.9	88.9	91.3	89.4	120.8
Foreign liabilities	40.0	39.7	53.7	71.9	65.8	54.8	66.8	54.8	64.1	75.4	75.4	86.7
Of which: use of Fund resources	29.3	31.2	42.0	42.7	55.1	42.7	55.1	42.7	52.0	63.3	63.3	74.6
Net domestic assets	23.4	19.6	30.8	58.8	40.0	68.7	37.4	35.0	43.7	57.6	57.5	41.4
Domestic credit	62.9	68.8	68.6	101.0	72.0	117.4	72.6	90.7	91.0	107.2	109.4	95.5
Government (net)	32.2	55.6	39.6	83.8	43.3	100.3	46.9	80.0	84.1	85.3	90.5	80.5
Central government	34.0	58.7	41.5	85.7	45.3	102.6	49.0	84.0	88.0	89.0	94.0	84.0
Other government	-1.8	-3.1	-1.9	-1.9	-2.0	-2.3	-2.1	-4.0	-3.9	-3.8	-3.5	-3.5
Nongovernment credit	30.7	13.2	29.0	17.2	28.7	17.0	25.7	10.7	6.9	21.9	18.9	15.0
Private sector	1.7	1.6	1.7	2.0	1.7	2.0	1.7	1.7	1.8	1.8	1.9	1.9
Commercial banks	23.5	10.2	21.3	11.2	20.0	11.8	18.0	6.5	6.2	22.8	20.6	18.7
Nonbank financial institutions	5.5	1.4	6.0	4.0	7.0	3.2	6.0	2.5	-1.1	-2.7	-3.6	-5.6
Other items, net (including revaluation)	-39.5	-49.2	-37.8	-42.2	-32.0	-48.7	-35.2	-55.7	-47.3	-49.6	-51.8	-54.1
Reserve money	62.7	55.2	67.2	71.2	69.8	69.3	71.7	70.1	68.4	73.6	71.5	75.5
Currency in circulation	51.5	44.5	54.8	56.4	56.5	54.6	58.2	58.0	54.3	61.7	57.7	62.9
Commercial bank reserves (including cash in vault)	10.7	9.6	11.7	13.5	12.6	13.7	12.7	10.2	12.2	10.0	11.9	10.8
Other nonbank deposits	0.5	1.2	0.7	1.3	0.7	1.1	0.8	1.9	1.9	1.9	1.9	1.9
Memorandum items:	(Units as indicated)											
Gross international reserves (U.S.S., millions)	...	...	...	58.5	...	50.3	...	81.7	84.6	87.0	85.1	115.0
M2 growth (12-month percent change)	22.0	23.1	18.6	13.0	20.4	14.6	15.1	18.6	18.9	15.8	15.3	14.9
Credit to the economy (12-month percent change)	15.0	5.9	3.5	8.0	4.1	9.1	5.0	12.4	2.5	9.8	8.1	17.5
Reserve money (12-month percent change)	25.9	10.9	21.6	33.4	30.2	29.4	14.4	26.9	21.8	3.3	3.2	7.7
Money multiplier (M2/reserve money)	2.8	3.1	2.8	2.5	2.8	2.7	2.8	2.9	2.9	2.8	3.0	3.1
Velocity (GDP/M2; end period)	3.6	3.7	...	...	...	...	3.7	3.6	...	...	...	3.5
Gross reserves (in months of imports c.i.f.)	4.7	5.3	4.9	3.1	4.5	2.7	4.7	4.3	4.2	4.4	4.3	5.8
Exchange rate (Burundi francs per U.S. dollar)	1,090	1,093	1,120	1,103	1,135	1,103	1,150	...	...	...	...	...

Sources: Bank of the Republic of Burundi (BRB); and Fund staff estimates and projections.

Table 5. Burundi: Balance of Payments, 2002-07

	2002	2003	2004		2005 Proj.	2006 Proj.	2007 Proj.
			Prog.	Proj.			
(In millions of U.S. dollars)							
Current account	-40.7	-36.5	-60.1	-135.9	-148.0	-129.9	-133.5
Trade balance	-72.7	-93.8	-107.5	-150.2	-145.2	-121.3	-115.3
Exports, f.o.b.	31.2	40.2	32.7	43.9	61.1	70.7	80.8
<i>Of which: coffee</i>	16.7	25.5	15.3	26.2	42.8	50.3	58.8
Imports, f.o.b.	-103.9	-134.0	-140.2	-194.1	-206.3	-192.0	-196.2
<i>Of which: petroleum products</i>	-15.9	-30.0	-21.3	-58.7	-60.5	-61.8	-63.5
Services (net)	-35.7	-27.7	-53.1	-94.7	-93.4	-81.7	-71.8
Credits	7.7	17.5	5.8	7.2	11.4	13.2	15.1
Debits	-43.3	-45.2	-58.9	-101.8	-104.8	-94.9	-86.9
Income (net)	-14.1	-20.1	-16.9	-21.9	-21.6	-19.0	-18.5
<i>Of which: interest on public debt (including IMF charges)</i>	-12.1	-13.4	-13.8	-10.8	-10.9	-9.7	-9.9
Current transfers (net)	81.8	105.2	117.5	130.9	112.2	92.1	72.1
Private (net)	5.5	7.0	9.0	7.4	8.2	9.2	10.2
Official (net)	76.3	98.2	108.5	123.6	104.0	83.0	62.0
Capital account	26.2	47.0	78.7	145.8	77.3	85.0	90.8
Project grants	14.1	33.0	14.0	73.1	50.0	55.0	57.8
Program grants	12.1	14.0	64.7	72.7	27.3	30.0	33.0
Financial account	2.6	-21.6	3.8	11.3	43.7	16.4	22.2
Direct investment	0.0	0.0	0.0	0.0	5.0	10.0	11.0
Medium- and long-term official loans (net)	1.9	-7.2	4.3	-0.5	45.1	6.6	11.4
Disbursements	34.6	41.9	38.1	35.0	79.4	43.0	45.5
Project loans	14.6	21.0	23.3	20.2	28.8	23.0	23.5
Program loans	20.0	20.9	14.8	14.8	50.6	20.0	22.0
Amortization (excluding IMF)	-32.7	-49.1	-33.8	-35.5	-34.4	-36.4	-34.0
Other capital	0.7	-14.4	-0.5	11.7	-6.3	-0.2	-0.2
Errors and omissions	-15.2	-0.9	0.0	4.2	0.0	0.0	0.0
Overall balance	-27.1	-11.9	22.4	25.4	-27.0	-28.4	-20.5
Financing (- increase in assets)	27.1	11.9	-22.4	-25.4	-0.9	4.8	-0.8
Change in central bank net foreign reserves (- increase)	-5.7	-9.8	6.2	0.7	-0.6	-4.7	-0.8
IMF, net	-10.0	-12.5	20.0	-10.4	-32.2	-21.1	-10.6
Other reserves, net	4.3	2.7	-13.7	11.1	31.6	16.4	9.7
Change in arrears (+ increase)	32.7	-5.4	-145.1	-125.0	-51.2	0.0	0.0
Exceptional financing 1/	0.0	27.1	116.5	99.0	50.9	9.5	0.0
Cancellation	0.0	0.0	0.0	33.3	0.0	0.0	0.0
Rescheduling of debt service and arrears	0.0	27.1	116.5	65.7	50.9	9.5	0.0
Financing gap				0.0	27.8	23.6	21.3
(In percent of GDP, unless otherwise indicated)							
Memorandum items:							
Trade balance	-11.6	-15.8	-16.7	-22.5	-18.6	-14.1	-12.5
Current account	-6.5	-6.1	-9.3	-20.4	-19.0	-15.1	-14.5
<i>Of which: excluding current official transfers</i>	-18.6	-22.6	-26.1	-38.9	-32.3	-24.8	-21.2
Gross official reserves							
In million of U.S. dollars	60.1	68.9	87.9	81.7	115.0	111.5	113.9
In months of imports, c.i.f.	5.9	5.3	6.5	4.3	5.8	6.0	6.0
Debt-service ratio (in percent of exports of goods and services)							
Scheduled current maturities (including IMF)	121.7	108.3	193.9	146.0	62.4	54.9	45.8
Actual payments on current maturities (including IMF ; after debt relief)	37.5	67.4	...	134.2	50.1	43.6	45.8
Nominal GDP (in millions of U.S. dollars)	628.1	595.5	645.0	667.2	780.9	857.6	923.4

Sources: Burundi authorities; and Fund staff estimates and projections.

1/ Including the March 2004 Paris Club rescheduling at Naples terms, and assuming rescheduling of current debt service and arrears to non-Paris Club creditors at comparable terms.

Table 6. Burundi: Structural Reform in 2004 and 2005

Measures	Status
Security and National Reconciliation	
• Cantonment of former rebel combatants.	22,000 former combatants reported to 12 cantonment camps as of end-October 2004.
• Demobilization of army personnel and former combatants.	The first combatants were demobilized in early December 2004 (75 from government forces and 141 from rebel forces).
• Resettlement of refugees and internally displaced people.	Refugees in UNHCR camps in Tanzania down from 500,000 in 2002, to 350,000 in 2003, to 269,000 in September 2004. Internally displaced people down from 400,000 in 2002, to 270,000 in 2003, to 120,000 in September 2004.
• Preparation of inventory of lands to be made available to refugees.	First half 2005 (originally 2004). Inventory likely to be concluded only following 2005 elections.
Poverty Reduction and Social	
• Preparation of full-PRSP.	May 2005. Work in process based on national consultations.
• Implementation of tracking mechanism for poverty-related expenditure.	December 2005 (with 2006 budget).
• Assess status of progress toward Millennium Development Goals (MDGs).	September 2005.
Fiscal Management and Transparency	
• Extension of the transactions tax to domestically produced goods and services.	Implemented in January 2004.
• Approval of a revised 2004 budget.	Revised budget approved in September 2004 providing for higher expenditures in connection with the peace process and the hiring of teachers and medical personnel. Customs service charge extended to all nondiplomatic imports.
• Raising of public social expenditure on social sectors.	From 5.4 percent of GDP in 2003; 6.7 percent in 2004; 7.0 percent in 2005 budget.
• Introduction of single taxpayer identification number.	First half 2005 (originally 2004). Procedures in place, but implementation pending on hiring of data systems expert.
• Adoption of a new budget and government accounts code.	December 2004. Apply with the 2005 budget.
• Reinforcement of key administrative capacity in the Ministry of Finance.	In 2005, skilled advisors and experts to be hired with the support of the World Bank PAGE project.
• Creation of an internal audit service in the Ministry of Finance.	2005.
• Completion of audited inventory of domestic arrears.	June 2005.
• Completion of civil service census and cleaning up of payrolls accordingly.	September 2005.
• Transfer of payroll management to Ministry of Finance.	September 2005. Payroll currently managed by the Ministry of the Civil Service.
Money and Exchange Regime	
• Enforcement of commercial bank compliance with prudential regulations.	Bank-by-bank assessment completed in March 2004. Minimum capital requirements rose substantially. Two noncompliant banks subsequently closed and being liquidated.

Table 6. Burundi: Structural Reform in 2004 and 2005

Measures	Status
• Adoption of enhanced money management tools.	Structure of BRB refinancing rate revised and tighter criteria for commercial bank reserves eligibility introduced in June 2004.
• Elimination of parallel market exchange differential.	Differential reduced by late 2004 to 2 percent from 30 percent in 2002.
• Liberalization of foreign exchange transactions.	Three foreign exchange bureaus established in 2004 and admitted to central bank foreign exchange auctions. Reporting and administrative requirements on current account transactions to be eased further in 2005.
• Mandatory nature of BRB auction reference rate for commercial bank transactions to be abolished.	December 2004. Official rate to be based on average market rates.
• BRB to unify its multiple bank-by-bank credit ceilings.	January 2005.
• Elimination of remaining export surrender requirements.	March 2005. Currently, 50 percent of proceeds of coffee, tea, and cotton exports have to be surrendered to central bank.
• Introduction market based liquidity auctions.	Spring 2005 (originally June 2004). IMF technical assistance in place.
Sectoral Policies	
Coffee	
• Financial audit of coffee marketing parastatal (OCIBU).	Audit completed in July 2004. Accumulated losses (of F Bu 20 billion) found to be higher than previously reported.
• Coffee sector liberalization.	Strategy approved October 28, 2004 (for tea, and cotton). First step of reforms of the OCIBU auctioning procedures and opening of sector to private enterprise implemented in December 2004. Liberalization of sales and marketing from March 2005.
• Launching tenders for sale of state-owned coffee processing assets.	June 2005.
• Downsize OCIBU into a regulatory agency.	Fall 2005.
Other	
• Reduction of number of tariff bands and their levels.	Implemented with 2005 budget. Number of bands reduced from four to three (10, 15, and 30 percent) with highest rate down from 40 percent.
• Establishment of the audit court (<i>Cour des Comptes</i>).	April 2005 (originally June 2004). Court members have been appointed and facilities set up. Low on status of magistrates in parliament. Operational establishment is pending statutory legislation and external training. Initiate audit of 2004 government accounts by May 2005.
• Introduction of new bankruptcy code.	New bankruptcy code with Parliament.
• Begin privatization of government assets in the financial sector.	2005.
• Lift trade restrictions and price controls in sugar sector.	September 2005.
• Set up one-stop office for setting up new enterprises.	November 2005.
• Introduce new investment code.	December 2005.

Table 7. Burundi: External Financing Requirements and Sources, 2003-06
(In millions of U.S. dollars)

	2003	2004		2005 Proj.	2006 Proj.
		Prog.	Proj.		
External resources (identified)	238.6	195.5	375.9	263.6	265.3
Exports of goods and services	57.6	38.5	51.1	72.5	83.9
Other private services	1.3	2.7	1.3	1.4	1.5
Private transfers (net)	7.0	9.0	7.4	8.2	9.2
Current official transfers (net)	98.2	108.5	123.6	104.0	83.0
Capital official transfers (net)	47.0	14.0	145.8	50.0	55.0
Foreign direct investment	0.0	0.0	0.0	5.0	10.0
Medium-and long-term official loans	41.9	23.3	35.0	28.8	23.0
Other capital	-14.4	-0.5	11.7	-6.3	-0.2
Use of resources	-237.7	-391.5	-380.1	-452.4	-369.5
Imports of goods and services	-179.2	-199.1	-296.0	-311.1	-286.9
Other private services	-8.1	-5.9	-12.5	-12.1	-10.8
Debt-service payments (including IMF charges)	-40.7	-192.7	-72.3	-96.4	-46.1
<i>Of which:</i> net accumulation of arrears (+)	-5.4	-145.1	-125.0	-51.2	0.0
Net change in reserves, excluding IMF (- increase)	-9.8	6.2	0.7	-32.7	-25.8
Errors and omissions	-0.9	0.0	4.2	0.0	0.0
Financing need		196.0		188.8	104.3
Program loans and grants		79.5		110.1	71.1
<i>Of which:</i> IMF PRGF disbursements		45.4		32.2	21.1
Debt relief (under existing mechanisms)		116.5		50.9	9.5
Residual financing need		0.0		27.8	23.6

Sources: Burundi authorities; and Fund staff estimates and projections.

Table 8. Burundi: Schedule of PRGF Disbursements and Reviews, 2004–07

Date	Disbursement (In millions of SDRs)	Conditions
Executive Board consideration, January 23, 2004	26.40 ¹	Executive Board approval. Disbursed
January 2005	7.15	Completion of first review, based on observance of performance criteria at end-June 2004
May 2005	7.15	Completion of second review, based on observance of performance criteria at end-December 2004
November 2005	7.15	Completion of third review, based on observance of performance criteria at end-June 2005
May 2006	7.15	Completion of fourth review, based on observance of performance criteria at end-December 2005
November 2006	7.15	Completion of fifth review, based on observance of performance criteria at end-June 2006
May 2007	7.15	Completion of sixth review, based on observance of performance criteria at end-December 2006

¹ Of which, SDR 19.25 million was for the early repayment of outstanding drawings under the post-conflict emergency assistance policy.

Table 9. Burundi: Balance of Payments, Medium-Term Scenario and Sensitivity Analysis, 2004-23

	2004	2005	2006	2007	2008	2009	2010	2015	2020	2023
	Est.	Projections								
(In millions of U.S.dollars)										
Current account	-135.9	-148.0	-129.9	-133.5	-130.7	-132.8	-134.2	-140.3	-148.0	-161.0
Trade balance	-150.2	-145.2	-121.3	-115.3	-112.6	-113.7	-117.6	-137.5	-151.7	-168.4
Exports, f.o.b.	43.9	61.1	70.7	80.8	90.8	100.1	108.8	164.0	249.6	307.7
<i>UJ wmicn: comec</i>	26.2	42.8	50.3	58.8	67.1	74.9	81.8	116.4	158.0	187.3
Imports, f.o.b.	-194.1	-206.3	-192.0	-196.2	-203.4	-213.7	-226.3	-301.5	-401.3	-476.1
<i>UJ wmicn: non-ou</i>	-135.4	-145.8	-130.2	-132.6	-138.1	-146.2	-154.7	-205.4	-272.5	-322.5
Services (net)	-94.7	-93.4	-81.7	-71.8	-65.0	-59.3	-56.2	-56.4	-66.9	-75.4
Income (net)	-21.9	-21.6	-19.0	-18.5	-18.4	-18.3	-18.7	-20.4	-23.3	-25.6
Current transfers (net)	130.9	112.2	92.1	72.1	65.2	58.4	58.3	74.0	93.9	108.3
Private (net)	7.4	8.2	9.2	10.2	11.3	12.5	13.1	16.7	21.4	24.7
Official (net)	123.6	104.0	83.0	62.0	54.0	46.0	45.2	57.3	72.6	83.6
Current account excluding official transfers	-259.4	-251.9	-212.9	-195.4	-184.6	-178.8	-179.3	-197.5	-220.5	-244.6
Capital account	145.8	77.3	85.0	90.8	96.1	101.8	108.0	113.4	124.5	133.7
Financial account	11.3	43.7	16.4	22.2	20.4	18.4	18.7	14.2	17.7	17.4
Errors and omissions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	25.4	-27.0	-28.4	-20.5	-14.2	-12.6	-7.5	-12.7	-5.7	-9.9
Financing (- increase in assets)	-25.4	-0.9	4.8	-0.8	-1.4	-2.0	-2.4	-3.2	-4.3	-5.1
Financing gap	0.0	27.8	23.6	21.3	15.6	14.6	9.9	16.0	10.0	15.0
(In percent of GDP, unless otherwise indicated)										
Memorandum items:										
Trade balance	-22.5	-18.6	-14.1	-12.5	-11.3	-10.6	-10.1	-8.1	-6.3	-5.7
Current account (incl. official transfers)	-20.4	-19.0	-15.1	-14.5	-13.1	-12.4	-11.6	-8.3	-6.2	-5.5
Current account (excl. official transfers)	-38.9	-32.3	-24.8	-21.2	-18.6	-16.7	-15.5	-11.7	-9.2	-8.3
Gross official reserves										
In millions of U.S. dollars	82	115	112	114	118	124	131	175	233	277
In months of imports, c.i.f.	4.3	5.8	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Nominal GDP (in U.S. dollars)	667	781	858	923	995	1,073	1,160	1,690	2,391	2,933
Real GDP growth rate	5.5	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Inflation rate (period average; in percent)	7.5	6.6	5.3	5.1	5.0	4.8	4.3	4.0	4.0	4.0
Exports-to-GDP ratio (in percent)	6.6	7.8	8.2	8.8	9.1	9.3	9.4	9.7	10.4	10.5
Imports-to-GDP ratio (in percent)	-29.1	-26.4	-22.4	-21.2	-20.4	-19.9	-19.5	-17.8	-16.8	-16.2
Sensitivity scenarios										
(In units indicated)										
Higher coffee prices 1/										
Current account (excl. official transfers)										
In millions of U.S. dollars		-241.2	-200.3	-180.7	-167.8	-160.0	-158.9	-168.4	-181.0	-197.8
In percent of GDP		-30.9	-23.4	-19.6	-16.9	-14.9	-13.7	-10.0	-7.6	-6.7
Financing gap (in millions of U.S. dollars)		17.1	11.1	6.6	-1.2	-4.1	-10.5	-13.1	-29.5	-31.8
In percent of GDP		2.2	1.3	0.7	-0.1	-0.4	-0.9	-0.8	-1.2	-1.1
Higher non-oil import prices 2/										
Current account (excl. official transfers)										
In millions of U.S. dollars		-259.2	-226.7	-215.8	-212.0	-213.4	-214.0	-232.2	-255.2	-279.3
In percent of GDP		-33.2	-26.4	-23.4	-21.3	-19.9	-18.5	-13.7	-10.7	-9.5
Financing gap (in millions of U.S. dollars)		35.1	37.4	41.7	43.0	49.3	44.6	50.6	44.7	49.7
In percent of GDP		4.5	4.4	4.5	4.3	4.6	3.8	3.0	1.9	1.7

Sources: Burundi authorities; and Fund staff estimates and projections.

1/ International prices are assumed to be 25 percent higher than the World Economic Outlook (WEO) baseline projection throughout the projection period.

2/ Non-fuel import prices are assumed to be 5 percent higher than the WEO projection baseline projection for 2005-09.

Bujumbura,
December 20, 2004

NREF: ___/___/04

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato,

1. On behalf of the Government of Burundi and the Bank of the Republic of Burundi (BRB), we hereby transmit the attached Memorandum of Economic and Financial Policies (MEFP) that sets out the objectives and policies under the program that the authorities intend to implement for the remainder of the 2004 and for 2005. The attached Technical Memorandum of Understanding (TMU) defines the terms and conditions of the program.

2. Burundi continues to make progress with national reconciliation and economic recovery. This progress has been aided by the Fund's advice and support under the Poverty Reduction and Growth Facility (PRGF) approved by the IMF's Executive Board on January 23, 2004. Nevertheless, we are aware that some slippages have occurred in 2004.

- The program's quantitative performance criteria on external arrears at end-June 2004 was not observed as the beginning stock of external arrears was larger, and clearing operations slower, than expected (Table 1). We have, however, made maximum efforts to clear our external arrears and no nonreschedulable arrears remained outstanding at end-September 2004. On this basis, we hereby request a waiver for the nonobservance of this quantitative performance criterion.
- The program's two structural performance criteria were not observed (Table 2). We have taken corrective measures to address the delays in structural reform, as described in the attached MEFP (paragraphs 9, 10, 26 and 32). On this basis, we hereby request waivers for the nonobservance of the two missed structural performance criteria.

3. In support of our macroeconomic and financial objectives and policies for 2004 and 2005, we hereby request completion of the first review under the PRGF and disbursement of SDR 7.15 million (9.3 percent of quota).

4. The objectives and policies in the updated MEFP remain consistent with Burundi's Interim Poverty Reduction Strategy Paper (I-PRSP—*Cadre stratégique intérimaire de croissance économique et de lutte contre la pauvreté*). Preparation of the full-PRSP is well under way, with the aim of issuing it by May 2005.

5. The authorities of Burundi will provide the Managing Director with all the information he may request as necessary to monitor developments and achieve the objectives of the PRGF-supported program in a timely manner.

6. The authorities believe that the economic and financial policies set forth in the attached MEFP are adequate to achieve the objectives of the 2004-05 program, supported by the PRGF, but will take any further measures that may become appropriate for this purpose. Burundi will consult with the Managing Director on the adoption of these measures in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultations.

7. The performance criteria and benchmarks for the second review will be based on end-December 2004 and end-March 2005 targets as set out in Tables 3 and 4 of the MEFP. The second review of the three-year PRGF arrangement with the Fund will be completed no later than May 31, 2005.

8. The Burundi authorities are keen to make this letter and the attached MEFP and the TMU, as well as the staff report on the first review under the PRGF arrangement, available to the public, and hereby authorize their publication and posting on the Fund's website subsequent to Executive Board consideration.

Sincerely yours,

/ s /

Athanase Gahungu
Minister of Finance

/ s /

Salvator Toyi
Governor, Bank of the Republic of Burundi

Annexes: Memorandum of Economic and Financial Policies for 2004-05
Technical Memorandum of Understanding

Burundi: Memorandum of Economic and Financial Policies for 2004-05

I. INTRODUCTION

1. This memorandum summarizes progress under the program for 2004, updates the medium-term objectives and policy framework, and sets out revised economic and financial policies through end-2004 and for 2005. On the basis of these policies, the authorities request Fund support in the form of a second disbursement under the three-year Poverty Reduction and Growth Facility (PRGF) arrangement. The policies and objectives of the new program remain consistent with the Interim Poverty Reduction Strategy Paper (I-PRSP).

II. BACKGROUND

A. Political Transition and the Peace Process

2. Burundi is at an advanced but crucial juncture in its political transition process. As envisaged under the Arusha agreement, national elections were to be held in time for a new government to take over on November 1, 2004. However, protracted negotiations on a new constitution necessitated an extension of the political transitional arrangements. On October 15, 2004 a summit of regional heads of state approved the extension of the transitional political arrangements, as well as a plan for local, communal, parliamentary, and presidential elections between February and April 2005. A draft constitution was agreed in Pretoria in August, and after some delay, has attracted broad political support and parliamentary approval. A national referendum on the constitution will be held in late 2004 or early 2005.

3. Hostilities in most of the country have ceased, but a remaining hold-out rebel group continues to stage sporadic attacks in the periphery of Bujumbura that prevent the upgrading of the security situation. United Nations peacekeeping troops are in place in Burundi. The military integration and demobilization program (DDR), a vital component toward achieving peace and security in Burundi, which is supported by the World Bank-led Multi-Country Demobilization and Reinsertion Program (MDRP) for the Great Lakes region, was declared effective September 10, 2004 and operations are well under way. As of November 2004, most former rebel combatants had reported to cantonment centers.

B. Recent Economic Developments

4. Macroeconomic developments have been broadly on track with program objectives. Real economic growth is expected to be slightly above the program target of 5 percent in 2004, as activity has been bolstered by a larger-than-expected recovery of coffee production tempered by a decline in other basic agricultural products. Inflation has been volatile but generally on a downward trend in 2004, with the three-month moving average hovering about 7-8 percent in the third quarter. Imports are surging (by a projected 35 percent) in 2004, largely on account of humanitarian assistance and nongovernmental organization project activity. World market coffee prices have been recovering from their lows, but the sharp rise in petroleum prices is weighing on the external and fiscal accounts. The Burundi

franc has remained broadly stable against the U.S. dollar and, reflecting the improved policy environment, the differential between the parallel and the official rate has narrowed sharply to 2-3 percent from about 15 percent in late 2003.

C. Performance Under the Program

5. Performance relative to the program in the first half of 2004 was mixed. The program's end-June quantitative performance criteria and the indicative targets for March, adjusted for a shortfall in external budget support, were observed, except for that on external arrears (Table 1). The beginning of period stock of external arrears was larger, and clearing operations slower, than expected. Reflecting unforeseen demands on public expenditure, the program's indicative targets on the government's wage bill and primary fiscal balance were both exceeded. The program's original indicative quantitative targets for September were mostly not met. Unfortunately, the program's two structural performance criteria—establishing an audit court (*Cour de Comptes*) and introducing domestic liquidity auctions—were not met (Table 2). However, the two structural benchmarks, on extending the transactions tax to domestically produced goods and on concluding an assessment of commercial banks' compliance with capital requirements were observed. The latter led to the closure of two noncompliant banks in mid-2004.

6. The government registered a primary deficit of 1.3 percent of GDP during the first half of the year, compared with a programmed surplus of 0.5 percent, as the government struggled with pressures to relieve rapidly rising petroleum prices and accommodate expenditures to support the peace process. Overall, revenue fell below the program target by some 0.6 percent of GDP, reflecting lower-than-envisaged tax receipts from oil products, owing to partial pass-through of the surge in world prices, as well as a smaller profit transfer from the Central Bank. The impact of the removal of customs duties for goods originating from countries in COMESA has been limited and offset by improved customs operations, through the introduction of the *Sydonia* customs management system, bonded warehousing, and pre-inspection of imports. Through September, primary spending was some 3 percent of GDP above program, in approximately equal proportions from larger-than-expected outlays needed to sustain the political transition and the peace process, payments of guaranteed coffee sector credit losses, and domestically financed project spending. At end-September, the government had paid off 0.3 percent of GDP of domestic arrears but had accumulated outstanding payment orders equivalent to 1½ percent of GDP. During the third quarter, F Bu 7.6 billion (1 percent of GDP) in treasury securities were issued to clear domestic arrears with private suppliers related to petroleum imports, which had been impacting negatively on bank asset quality. F Bu 7.6 billion of guaranteed coffee sector credit losses were also paid. Project spending, financed by highly concessional external support, has increased strongly to well above program levels, with the associated increase in counterpart outlays.

7. Following discussions with Fund staff, a revised 2004 budget was signed into law on September 30, 2004, which targets a primary deficit of close to 3 percent of GDP, compared with a balanced position under the original program. The revised budget broadens the application of the 6 percent import service charge to all nondiplomatic imports and incorporates a 6 percent wage increase for civil servants (delayed from January). It also

provides for the hiring of 2,300 new teachers and 500 medical personnel, which are sorely needed.

8. Reserve money growth, which had risen rapidly in the first half of 2004, eased in the third quarter to 29.4 percent over the year ending September. Delays in external budget support led to a further increase in net credit to the government while the central bank's (BRB) net foreign asset position deteriorated. In the circumstances, banks' demand for credit from the central bank fell well short of the ceilings, which the BRB lowered significantly from May onwards. As a result, apart from credit to government, the NDA of the BRB was broadly unchanged in the first three quarters of 2004. Broad money growth declined to 14.6 percent in September (20.4 percent in the program). The annual rate of increase in credit to the economy has been steady at about 9 percent in the first three quarters of the year, somewhat above the rate of inflation. Gross official reserves declined to US\$51 million, about 2½ months of goods and services import cover, at end-September. The authorities consider the reduction in the exchange rate differential between the official and parallel markets to under 3 percent in November 2004 (the lowest level in over a decade), a major accomplishment of their policy efforts. This important development reflects the admission of foreign exchange bureaus as participants in the BRB's weekly foreign exchange auctions, as well as increased foreign aid inflows and, since September, an import pre-inspection requirement.

9. The BRB has implemented several measures to enhance monetary management in line with its objective of switching from bank-by-bank credit ceilings to indirect monetary control. It has also strengthened prudential supervision and closed down two insolvent financial institutions. As regards the end-June structural performance criterion on monetary policy reform, two components—the introduction of the marginal refinancing window at a penalty rate and the reform of mandatory reserves (now held in the form of remunerated central bank deposits)—were implemented, but weekly liquidity auctions were not launched due to continued operational shortcomings (the nonavailability of reliable liquidity forecasts and key macroeconomic data). A specialized technical assistance team from the IMF visited Bujumbura in November 2004 to assist, inter alia, in such a move.

10. The implementation of structural reforms in other areas has lagged somewhat, reflecting the complex political environment and weak administrative capacity. The establishment of an audit court has been delayed from the end-March target (performance criterion). While the audit court law was passed at end-March 2004, its magistrates were appointed only in June 2004. A law needed to define the magistrates' legal status was approved by the council of ministers and submitted to parliament. An action plan for the court was approved by the council of ministers on October 28, 2004 to render it operational by April 2005. Financing has been obtained and training and logistical issues are being worked out so that the court can begin to audit the 2004 government accounts by the spring of 2005.

11. The performance of the coffee sector continued to pose grave concerns. The 2003-04 campaign continued to be conditioned by weak, but recovering, world prices and large sectoral inefficiencies. Production rose to around 38,000 tonnes, but processing constraints

have led to delays in transformation and exports. An audit of the parastatal coffee agency (OCIBU) was undertaken in June by experts sponsored by the European Union (EU). The results showed that the campaign losses for 2002-03 were higher than previously thought (F Bu 7 billion, compared with F Bu 5 billion). Accumulated losses since 2000-01 in excess of F Bu 15 billion (2 percent of GDP) have translated into defaults on bank loans that trigger a government guarantee. Deep seated reforms are needed to attract much needed private investment and financing, improve quality, bolster incomes of small producers, and eliminate the source of large losses accruing to the budget. A comprehensive reform strategy, elaborated with World Bank and EU support, features the early liberalization of investment, marketing, and export of coffee, as well as the reform and dismantling OCIBU's marketing monopoly. The strategy was approved by the council of ministers on October 28, 2004. A decree will be issued by end-December to reform OCIBU's auction mechanism to include representatives of commercial banks, producers, and washing stations and to permit private investment in the sector.

12. Burundi has continued efforts to complete bilateral rescheduling agreements and remains current on its nonreschedulable obligations. Following its first Paris Club rescheduling in March 2004, the authorities recently signed the penultimate bilateral agreement. Discussions are ongoing to secure comparable treatment from other bilateral and commercial creditors. In addition, the clearance of the remaining arrears with multilaterals (the AfDB, the EU/EIB, and the OPEC Fund) has been completed and the AfDB has lifted its sanctions against lending to Burundi.

III. MEDIUM-TERM OBJECTIVES AND POLICIES

13. The main orientations of the government's medium-term policies are drawn from the Arusha agreement of August 2000 and the priorities set in the government's I-PRSP of November 2003, which remain broadly appropriate and attainable. The elaboration of a full-PRSP on the basis of extensive consultations at the local level with private and public stakeholders is well advanced and is expected to be completed by May 2005.

14. The authorities believe that elaboration of a full-PRSP and successful implementation of the PRGF-supported program will serve as catalysts for a further increase in foreign assistance, including debt relief under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC Initiative). Notwithstanding the debt relief obtained from the Paris Club in March, Burundi's debt burden remains unsustainably high. A preliminary debt sustainability analysis prepared jointly by IMF and World Bank staff indicates an external debt ratio at end-2003, on a present value basis, of almost 2,000 percent of exports. Substantial relief would thus be needed to bring Burundi's debt burden down to sustainable levels and free resources for much needed social and poverty reduction spending. A preliminary HIPC document will be presented to the IMF and World Bank Executive Boards at the time of the first PRGF review.

IV. The Updated 2004-05 Program

A. Macroeconomic Objectives

15. The strategy for the remainder of 2004 and 2005 seeks to consolidate the progress achieved on economic recovery and financial stabilization, address slippages, and deepen needed financial and structural reforms. Accordingly, the program performance targets for end-December 2004 and for 2005 reflect the latest developments and priorities (Table 3). The updated program aims at maintaining economic growth at about 5 percent in 2004-05 and lowering inflation to 8½ percent in 2004 and 5½ percent in 2005. The original inflation target for 2004 of 5½ percent is out of reach, reflecting much higher world petroleum prices, lower basic food harvest, and higher-than-programmed liquidity creation through midyear. To achieve these objectives, it will be necessary to contain the overall fiscal deficit (on a cash basis and after external grants), in line with the approved revised 2004 budget, at 8.0 percent of GDP in 2004 and 6½ in 2005. This overall deficit is consistent with primary deficit targets of 3 percent of GDP in 2004 and 2 percent in 2005. Reflecting increased foreign assistance inflows, the external current account deficit is expected to widen to about 20 percent of GDP in 2004 and to 19 percent in 2005.

16. Taking into account a projected improvement in private investment, together with low private savings, Burundi will remain highly dependent on the availability of large amounts of external resources to achieve the 2005 program growth and inflation objectives. Progress in addressing the overwhelming humanitarian and social needs, the demands of national reconstruction, and the restoration of public security, will require sustained and reinforced external assistance on highly concessional terms. Foreign assistance, in the form of grants, highly concessional loans, and debt relief, are expected to average about US\$400 million in 2004-05. Commitments of grants from bilateral donors have been secured to cover for the costs of the referendum in 2004 and the general elections in 2005. Of particular importance at this time is the need to secure funding of the costs associated with vital security programs. These costs will be closely monitored and require timely and appropriate external support to ensure that they do not destabilize the budget and macroeconomic balances.

17. The authorities are committed to accelerating the implementation of structural reforms, needed to support the economic recovery, ensure its sustainability, and reduce poverty. The program aims at the liberalization of key sectors, such as coffee and sugar; a strengthening of government financial management; improvements in the delivery of social services; further liberalization of the trade and exchange regimes; and improvements in governance and transparency.

B. Fiscal Policy

18. The 2004 revised budget aims at a primary deficit of 3 percent of GDP. Revenues are cautiously projected at 19.4 percent of GDP in 2004, somewhat lower than originally programmed, as the better performance of domestic taxes would offset only partially the shortfall in tax receipts from petroleum products and profit transfers from the central bank. Expenditure increases relative to the program involve primarily transfers to cover coffee

sector losses, outlays for peace and reconciliation, and the rebuilding of public administration and social services. Apart from the recent issuance of treasury bills to clear domestic arrears with oil suppliers (which in turn settled their own arrears with the banks), there would be no further domestic financing of the government relative to end-June 2004 levels. The overall fiscal balance after grants (on a commitment basis) would be about zero. The budget financing gap for 2004 has been closed.

19. The 2005 budget will be presented to parliament in late December 2004 (prior action). In view of the slippages in 2004, fiscal policy will be geared at avoiding any further erosion of revenues by addressing customs exonerations and evasion, and at containing increases in expenditure. The primary deficit is targeted to decline to 2 percent of GDP, allowing for essential outlays in connection with the political transition and a further increase in social spending to 7 percent of GDP. The overall deficit, on a commitment basis and after grants, will rise to 3½ percent of GDP in 2005, reflecting a further increase in project spending and special programs.

20. Overall revenue in 2005 is expected to decline somewhat to about 19 percent of GDP, owing to the impact of an import duty reduction (0.3 percent of GDP). Primary expenditure would be reduced by 1 percentage point of GDP, to about 23 percent of GDP, by lowering transfers to cover coffee sector losses and containing the growth in the wage bill (including the military but excluding the newly created national police force) and expenditures on goods and services to 6 percent and zero, respectively. Budget support from multilaterals is expected to rise strongly to about US\$68 million in 2005, while bilateral grant assistance would decline somewhat to about US\$11 million. Reflecting the initiation of a national privatization program, receipts from the sale of state assets, especially in the financial and coffee sectors, are projected at about F Bu 5 billion (0.6 percent of GDP). Any resources received over and above this amount will be used to reduce domestic debt. A remaining financing gap of about US\$28 million is expected to be covered by bilateral grants. This level of concessional financing would allow for a reduction in domestic arrears and the government's net indebtedness to the banking system.

21. Project expenditure (F Bu 110 billion, 13½ percent of GDP) will continue to be financed mostly from external aid disbursements and will give priority to rehabilitating and rebuilding the social and economic infrastructure. Aggregate poverty-related expenditure (as defined in the I-PRSP) is set to increase from 28 percent of primary expenditure in the 2004 revised budget to 31 percent in 2005. The latter amount does not take into account possible increases from the diversion of resources from debt service to social services subsequent to debt relief under the enhanced HIPC Initiative, from mid-2005.

22. As regards tax policy, the government will lower and simplify import tariffs with a view to reducing smuggling, simplifying administration, and boosting trade. Accordingly, the 2005 budget reduces the maximum tariff rate from 40 percent to 30 percent and folds the 12 percent band into the 10 percent band, for a reduction in the number of bands to three. The net revenue loss is expected at about F Bu 2 billion and would be partially compensated by additional revenues from the full-year effect of the extension (in late 2004) of the customs service tax. The cooperation of the international agencies established in Burundi is being

sought to reinforce the application of income tax legislation to Burundians employed by international agencies. The introduction of a value-added tax system, originally envisaged for 2005, has been postponed pending further preparatory work.

23. The authorities are committed to improving the management of the public finances. With technical and financial support from key donors, notably the World Bank's Economic Management Support Project (PAGE), the EU, and bilateral donors, the Ministry of Finance will seek, in the course of 2005, to create a new internal audit service with appropriately qualified and paid staff; to enhance civil service payroll management, which will be transferred to the Ministry of Finance from the Ministry of the Civil Service by June 2005; to improve expenditure control through the introduction of a new public accounting and budgetary code with effect from the 2005 budget (prior action); and to introduce a single taxpayer identification number (March 2005).

24. The government is committed to normalizing the government's financial relations with suppliers and establishing the nature and extent of its domestic arrears, which weigh heavily on the private sector, including the banking system. To that end, an inventory of domestic arrears financed through the World Bank PAGE project will be launched before end-2004. Suppliers will be asked to submit their claims and the inventory results will be subject to an external audit before end-June 2005. A strategy for the clearance of arrears will be worked out in the context of the second review under the PRGF arrangement.

C. Monetary and Exchange Policies

25. Pressure on monetary policy resulting from delayed budget support and higher-than-expected government spending is expected to ease in late 2004 with the disbursement of key aid (about US\$34 million from the EU and the World Bank). Broad money growth is projected to be broadly in line with the program at about 19 percent by end-2004. Reserve money growth would decline from its midyear high, to about 27 percent by year's end, owing to the reduction in bank credit to the government and the recent tightening of the BRB's ceilings on credit to banks. Gross international reserves are expected to rise sharply in late 2004, to about \$82 million (4¼ months of imports). For 2005, a reduction in credit to government and much lower coffee credit would result in a sharp decline in the growth of reserve money to less than 10 percent. The increased efficiency of the financial system, resulting from the various reform efforts would lead to a moderate increase in the money multiplier and broad money growth of about 15 percent in 2005. Assuming a further modest decline in velocity, the fiscal program would allow credit to the private sector to grow by about 17 percent, somewhat more than nominal GDP. Assuming the financing gap is closed, gross international reserves would increase further to about 5.8 months of imports by end-2005.

26. In 2005, the BRB intends to maintain a tight monetary stance to support the program's inflation objective. Critical to this effort will be measures to enhance the efficiency and effectiveness of liquidity management and the rapid phasing out of the government guaranteed coffee credit regime. In this regard, the BRB, supported by IMF technical assistance, will work to enhance its liquidity forecasting capabilities and plans to

introduce weekly liquidity auctions and a rediscount facility by the spring of 2005. Further, the BRB and the Ministry of Finance will work to standardize treasury bills and make them tradable. This will enable better liquidity management in the banking system and support a more active monetary policy.

27. Overall, Burundi's financial sector remains generally sound, although some banks appear vulnerable. Following a strengthening of minimum capital requirements (more than tripled) in March 2004, the BRB is monitoring the orderly liquidation of the two closed banks. In 2005, continued efforts will be made to strengthen bank supervision, and the existing prudential requirements will be tightened gradually toward international standards. The BRB is also committed to improving its own governance and transparency. To this end, it has signed a multiyear external audit contract to begin with the 2004 accounts.

28. The BRB is committed to pursuing exchange system liberalization. To that effect, in late 2004, the BRB abolished the mandatory nature of its auction reference price for commercial transactions. The determination of the official exchange rate was also changed from the weekly auction to the daily average of market rates. The BRB will publish the average daily exchange rates and spreads in the market. The remaining surrender requirement (50 percent on coffee, tea, and cotton exports) will be abolished by March 2005 (performance criterion), which will contribute to a more efficient market for foreign exchange. With the support of IMF technical assistance, the restrictions and reporting requirements on foreign exchange transactions will be further reduced in 2005.

D. Structural Reforms

29. In addition to the reform measures in the areas of public financial management, tariff reform, and exchange liberalization described above, other priorities include the liberalization of key productive sectors and improved governance.

30. Implementation of the recently approved reform strategy for the coffee sector will be key to poverty reduction in Burundi, in particular among the large number of small rural producers. The reform action plan (that also concerns the tea and cotton sectors) is being put rapidly into effect. In late 2004, a decree was signed allowing private investment at all levels of the supply chain. The restrictions on export and sale of coffee at all levels of the chain will be abolished in early 2005, including the obligation to go through the OCIBU auction mechanism. In early 2005, the authorities will host a sectoral colloquium, supported by the World Bank and the EU, to bolster understanding of the reforms. By June 2005, the coffee processing infrastructure owned by government will be offered for sale. The government, with foreign technical assistance, will also begin transforming OCIBU into a regulatory and support agency in 2005. One of the objectives of the coffee sector reform is to rapidly phase out the government's crop credit guarantee. The authorities will not grant any new coffee crop credit guarantee in the transitional period of 2005/06 without prior consultations with Fund staff.

31. The government also intends to deregulate the sugar sector during 2005 by liberalizing domestic prices, reducing the minimum import valuation, and lifting export and

domestic distribution restrictions. These measures are expected to be completed by September 2005 and to result in lower sugar prices, to benefit the poorer segments of the population, and to better prospects for the development of the domestic sugar industry.

32. The audit court is one of the institutions contemplated in the Arusha agreement, and the government undertakes, in conjunction with parliament, to ensure that it starts its operations in full in April 2005. The court's magistrates, appointed in June 2004, took their oath of office in September, and, following a period of training through April 2005, will start their functions by auditing the 2004 budget accounts as soon as they become available. The last major hurdle to the court's establishment is expected to be overcome in December 2004 with the passing of the necessary legislation on the statutes of the magistrates.

E. Program Financing and External Debt Management

33. For 2005, the external nonproject financing need is estimated at US\$190 million. This external financing requirement is expected to be covered by commitments from the World Bank (two tranches of the ERC2 credit totaling US\$30 million); AfDB program grants and loans from the 9th and 10th FAD of about US\$21 million; the EU (FED program of about US\$14 million); bilateral creditors (US\$11 million); and debt relief. The remaining gap of US\$28 million is reasonably expected to be covered, including through a possible donors' meeting in the spring of 2005. Funding for the constitutional referendum in late-2004 and the national elections (a total of about US\$23 million) has been secured, largely from bilateral donors. It is expected that Burundi will be in a position to meet its external nonreschedulable debt-service payments and the authorities are determined to pursue prudent debt management policies and to strive to reach a sustainable external debt position.

F. Safeguards, Statistical Issues, and Technical Assistance

34. The BRB is committed to improving its operations consistent with the principles of good governance included in the IMF's safeguards guidelines. In view of constrained administrative and technical capacity, a two-step approach to the safeguards assessment was adopted. The first stage, which has been successfully completed, involved an assessment of the areas considered critical to preventing the possibility of misreporting and safeguarding Fund resources, notably an external audit of the BRB's accounts, financial reporting mechanisms, and the system of internal controls. The second stage, which is expected in 2005, will evaluate the BRB's legal framework and internal audit mechanism. In line with the staff recommendations under the first stage, the BRB is acting to improve financial reporting mechanisms and strengthen its system of internal controls. Following the appointment of the Ernst and Young audit firm, work began in November 2004 on its first external audit. The external auditors will also make recommendations on the adoption of International Financial Reporting Standards (IFRS).

35. Burundi has extensive technical assistance needs, and the authorities will continue to work closely with multilateral and bilateral partners to rebuild administrative capacity in priority areas. These include tax and customs administration, civil service reform, monetary and exchange rate policy, and banking supervision. Assistance will also be needed to

improve economic statistics, notably as regards the national accounts, the balance of payments, and social/poverty indicators. The authorities are committed to improving the national statistical base and implementing the recommendations of an IMF multi-sector statistics mission, which visited Bujumbura in November-December 2004. The authorities have requested the posting of an IMF resident representative in Bujumbura.

V. PROGRAM MONITORING AND REQUEST FOR WAIVERS

36. The government requests waivers for the nonobservance of the performance criteria on the establishment of the audit court (March 2004), the introduction of liquidity auctions (June 2004), and the end-June 2004 ceiling on external arrears. In support of its request, the authorities note that a complex political environment and weak administrative capacity led to the delays in the nomination of the audit court's magistrates and the introduction of liquidity auctions. Steps have been taken to address these concerns, and both measures are in process. The end-June 2004 ceiling on the stock of external arrears was exceeded because of an upward revision of the historic stock estimated at the time the 2004 program was designed and slower clearance. Nonreschedulable arrears have now all been cleared and negotiations are continuing with non-Paris Club creditors.

37. Table 3 summarizes the quantitative performance criteria (end-December 2004 and end-June 2005) and quantitative indicators for program monitoring purposes. The prior actions, structural performance criterion and benchmarks under the program for 2004-05 are presented in Table 4. In the context of the coffee sector reform, the authorities aim to rapidly do away with the crop credit guarantee, and any new coffee credit guarantee will not be accorded prior to consultations with Fund staff. The program performance target on credit to government will be adjusted downward for any accumulation of domestic arrears, as defined in the TMU. The definitions of the program's performance targets, external assistance adjusters, and underlying assumptions, as well as Burundi's reporting requirements are discussed in the attached TMU. Burundi will avoid incurring overdue financial obligations to the Fund, as well as introducing new exchange restrictions, multiple currency practices, bilateral payments agreements inconsistent with Article VIII of the Fund's Articles of Agreement, and import restrictions for balance of payments purposes. In addition, the authorities stand ready to adopt any new financial or structural measures, in consultation with Fund staff, which may become appropriate to ensure program success.

38. The second review under the PRGF arrangement is scheduled to be completed by May 2005 and will be conditional upon the observance of quantitative performance criteria at end-December 2004, and the structural performance criterion at end-March 2005. The second review will focus on coffee sector reform, public financial management, domestic arrears, monetary and exchange reform, and privatization. Completion of the second review and presentation of a preliminary DSA form the basis for reaching the Decision Point under the Enhanced HIPC Initiative.

Table 1. Burundi: Performance Criteria and Indicative Targets Under the 2004 Program
(In billions of Burundi francs, unless otherwise indicated)

	2003		2004									
	Dec.		Mar.		Jun.		Sep.		Dec. 1/			
	Prog. est.	Act.	Prog.	Adj.	Prog.	Adj.	Prog.	Adj.	Prog.	Act.		
	(IMF Country Report No. 04/41)											
Performance criteria for end-June 2004 (indicative targets otherwise)												
Floor on the stock of net foreign assets of the central bank (in millions of U.S. dollars; including IMF assistance drawings) 2/	36.1	32.6	29.0	9.8	24.7	32.6	-11.5	11.2	26.3	5.2	0.6	29.8
Ceiling on stock of net domestic assets of the central bank 2/	23.4	19.6	32.6	50.1	29.0	30.8	70.8	58.8	40.0	59.1	68.7	37.4
Ceiling on the stock of net credit from the banking system to the government 2/	34.5	46.1	35.9	53.4	51.4	39.6	88.2	71.7	45.5	68.7	93.5	49.2
Ceiling on central government's outstanding external payments arrears (in millions of U.S. dollars) 3/	167.5	176.8	145.3	...	94.4	59.0	...	94.9	22.4	...	...	22.4
Ceiling on central government's outstanding stock of short-term external debt with a maturity of less than one year (in millions of U.S. dollars) 4/	0.0	0.0	0.0	...	0.0	0.0	...	0.0	0.0	...	0.0	0.0
Ceiling on new nonconcessional external debt contracted or guaranteed by the central government or the central bank (cumulative from beginning of calendar year; in millions of U.S. dollars) 5/ 6/	0.0	0.0	0.5	...	0.0	0.5	...	0.0	1.0	...	0.0	1.0
Indicative targets												
Floor on the primary balance of the government budget, excluding externally financed projects (cumulative from beginning of calendar year) 7/	-1.9	-5.4	6.5	...	-2.4	3.9	...	-8.5	9.4	...	-22.9	0.1
Ceiling on the government's wage bill (cumulative from beginning of calendar year)	54.9	53.8	14.8	...	15.0	28.6	...	30.2	43.5	...	44.6	58.4
Memorandum items for adjuster calculations:												
External nonproject financial assistance (cumulative from beginning of calendar year; in millions of U.S. dollars) 8/	40.1	41.8	37.2	...	11.6	76.1	...	17.3	77.3	...	49.2	88.8
Quarterly average exchange rate (Burundi francs per U.S. dollar)	...	1,086	...	...	1,096	...	...	1,103	...	...	1,103	...

1/ Tentative projections to be revised in the context of the first program review.
2/ The ceiling or the floor will be adjusted to accommodate 100 percent of any deviation from the projected disbursements of external nonproject financial assistance shown in the memorandum item. In case of, respectively, a financing excess (shortfall), the floors on the stock of net foreign assets of the central bank will be adjusted upward (downward), and the ceilings on the stock of net domestic assets of the central bank and on the stock of net credit from the banking system to the government will be adjusted downward (upward). External financing will be converted in terms of Burundi francs on a quarterly basis, using the average official exchange rate.
3/ Projection for September and December 2004 corresponds to outstanding arrears to the African Development Bank Group (AIDB) that have been deferred in line with understandings reached with AIDB staff in June 2003.
4/ Excluding short-term, import-related trade credits.
5/ With a grant element of less than 35 percent.
6/ A small nominal amount is allowed under the program on account of working credits from embassy suppliers that at times may show positive net values.
7/ The performance criteria table in IMF Country Report No. 04/41 mistakenly included a financing adjuster to the primary balance.
8/ Nonproject assistance includes debt relief on current maturities, which was mistakenly omitted from Table 3 of Appendix I of IMF Country Report No. 04/41.

Table 2. Burundi: Prior Actions, Structural Performance Criteria,
and Structural Benchmarks Under the 2004 Program

Measures	Timetable (End-month deadline)	Status
Prior actions		
<ul style="list-style-type: none"> Elimination of all remaining exchange restrictions on current account transactions and bona fide amortization payments 	September 2003	Implemented
<ul style="list-style-type: none"> Adoption by parliament of a budget law for 2004 in line with program objectives 	December 2003	Implemented
Structural performance criteria		
<ul style="list-style-type: none"> Establishment of new auditing court (<i>Cour des comptes</i>) 	March 2004	Missed but in process; court law passed in March; justices appointed in June; action plan with identified financing approved by council of ministers in October; magistrates status law was approved by the council of ministers and submitted parliament; court to be fully operational by April 2005 to audit 2004 government accounts
<ul style="list-style-type: none"> Adoption of weekly liquidity auctions and introduction of a marginal refinancing window at a penalty rate, and reform of the system of mandatory reserve requirements, with reserves to be held only in the form of deposits with the BRB 	June 2004	Implemented, except for liquidity auctions. MFD mission (November 2004) to assist BRB introduce liquidity management measure
Structural benchmarks		
<ul style="list-style-type: none"> Extension of the transactions tax to domestically produced goods and services 	January 2004	Implemented
<ul style="list-style-type: none"> Assessment that all banks in operation meet the minimum capital requirement 	March 2004	Implemented: two noncompliant banks closed

Table 3. Burundi: Performance Criteria and Indicative Targets for 2004-05
(In billions of Burundi francs, unless otherwise indicated)

	2004		2005				
	June Act.	Sep. Act.	Dec. Rev. Prog.	Mar. 1/ Prog.	June Prog.	Sep. 1/ Prog.	Dec. 1/ Prog.
Performance criteria for end-December 2004 and end-June 2005 (indicative targets otherwise)							
Net foreign assets of the BRB (floor; in millions of U.S. dollars) 2/	11.2	0.6	31.9	23.5	15.2	13.3	32.5
Net domestic assets of the BRB (ceiling) 2/	58.8	68.7	35.0	43.7	57.6	57.5	41.4
Net credit from the banking system to the government (ceiling) 2/ 3/	71.7	93.5	78.1	82.2	81.3	88.5	68.6
External payments arrears of the government (ceiling; in millions of U.S. dollars)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Of which:</i> arrears to AIDB	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Short-term external debt of the government (ceiling; in millions of U.S. dollars) 4/	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nonconcessional external debt contracted or guaranteed by the government or the BRB (ceiling; cumulative; in millions of U.S. dollars) 5/	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Indicative targets							
Primary balance of the government (ceiling; cumulative from beginning of calendar year) 6/	-9.5	...	-23.8	0.4	-4.9	-10.8	-15.3
Government's wage bill (ceiling; cumulative from beginning of calendar year)	30.2	...	61.8	16.3	32.6	48.9	65.2
Memorandum item:							
External nonproject financial assistance (cumulative from beginning of calendar year; in millions of U.S. dollars) 6/ 7/	17.3	49.1	93.2	13.1	42.1	61.1	114.4

1/ Indicative targets: December 2005 target to be set in the context of the second review.

2/ The ceiling or the floor will be adjusted to accommodate 100 percent of any deviation from the projected disbursements of external nonproject financial assistance shown in the memorandum item. In case of, respectively, a financing excess (shortfall), the floors on the stock of net foreign assets of the central bank will be adjusted upward (downward), and the ceilings on the stock of net domestic assets of the central bank and on the stock of net credit from the banking system to the government will be adjusted downward (upward). External financing will be converted in terms of Burundi francs on a quarterly basis, using the average official exchange rate.

3/ The ceiling on net credit to the government from the banking system will be adjusted downward for any accumulation of domestic arrears as defined in the Technical Memorandum of Understanding.

4/ Excluding short-term, import-related trade credits.

5/ With a grant element of less than 35 percent.

6/ As defined in the TMU.

7/ Nonproject assistance includes debt relief on current maturities and net cash payments to clear arrears.

Table 4. Burundi: Prior Actions for the First Review under the PRGF and Structural Performance Criterion and Benchmarks for 2005

Measure	Timetable (End-month deadline)	Status
Prior actions		
• Presentation of 2005 budget to parliament consistent with program objectives		
• Introduction of the new budget and accounting charter with 2005 budget		
• Submission to parliament of law on statute of magistrates of the audit court (<i>cour des comptes</i>)		
Structural performance criterion		
• Abolish remaining export surrender requirement (50 percent of coffee, tea, and cotton exports)	March 2005	
Structural benchmarks		
• Issue decree for the liberalization of coffee sector marketing and trade at all levels of the production chain	March 2005	
• Begin privatizing coffee sector assets by launching tenders for Sogestals, washing stations, and the state share in SODECO	June 2005	
• Initiate audit, by the audit court, of the 2004 government accounts	May 2005	
• Complete audited inventory of domestic arrears	June 2005	
• Lift trade restrictions and price controls on sugar	September 2005	

Burundi: Technical Memorandum of Understanding

December 20, 2004

1. This Technical Memorandum of Understanding sets out the definitions of program variables to monitor the implementation of the program and the reporting requirements for the government of Burundi and the Bank of the Republic of Burundi (BRB). It defines (i) the quantitative performance criteria and indicative targets and the applicable adjuster; and (ii) the key assumptions used in formulating the economic program for 2004/05 set out in the Memorandum of Economic and Financial Policies (MEFP) of the government of Burundi annexed to the letter of December 20, 2004 from the Minister of Finance and the Governor of the BRB to the Managing Director of the International Monetary Fund.

2. The prior actions, the structural performance criteria, and the structural indicators are listed in Table 4 of MEFP.

A. Quantitative Program Targets

Quantitative performance criteria and indicative targets

3. Quantitative performance criteria under the program are set on the end-December 2004 stocks as set out in Table 3 of the MEFP, as follows:

- Net foreign assets of the BRB (floor);
- Net domestic assets of the BRB (ceiling);
- Net credit from the banking system to the government (ceiling);
- Central government's external payments arrears (ceiling);
- The outstanding stock of short-term external debt (maturity of less than one year) of the central government and the BRB (ceiling); and
- New nonconcessional medium- and long-term external debt contracted or guaranteed by the government or the BRB (ceiling).

The quarterly targets on the above variables for 2005 are indicative.

4. Quantitative indicative targets under the program, as set out in Table 3 of the MEFP, are as follows:

- Primary budget balance, excluding externally financed projects (floor); and
- The government's wage bill (ceiling).

Definitions and computation

5. The **net foreign assets of the BRB** are defined as the difference between (i) foreign exchange assets and gold holdings (valued at market prices), and (ii) foreign exchange liabilities to nonresident entities (including the use of Fund resources, but excluding the counterpart of SDR allocations). These amounts are valued in terms of U.S. dollars based on end-June 2004 exchange rate. The net foreign assets of the BRB totaled F Bu 12.4 billion, equivalent to US\$11.2 million, at end-June 2004, broken down as follows:

	In billions of Fbu	In millions of U.S. dollars
Net foreign assets of the BRB	12.4	11.2
Foreign assets	84.3	76.4
Deposits with correspondents (excluding IMF)	81.8	74.2
SDR holdings	0.2	0.2
Reserve position with the IMF	0.6	0.5
Gold holdings	0.4	0.4
Cash on hand	1.3	1.2
Foreign liabilities	71.9	65.2
Liabilities vis-à-vis correspondents (excluding IMF)	27.2	24.7
Counterpart of the use of IMF resources	42.7	38.7
Other liabilities	2.0	1.8

6. The **gross official reserves of the BRB** are defined as those foreign assets which are liquid and freely available to the central bank. At end-June 2004, gross official reserves stood at US\$58.5 million.

7. The **net domestic assets of the BRB** are defined as the difference between (i) reserve money, comprising currency in circulation, reserves of commercial banks, and other deposits held at the BRB, and (ii) net foreign assets of the BRB. Net domestic assets of the BRB totaled F Bu 58.8 billion at end-June 2004, broken down as follows:

Net domestic assets of the BRB	58.8
Reserve money	71.2
Currency in circulation	56.4
Reserves of commercial banks	13.5
Other nonbank deposits	1.3
Minus: net foreign assets of the BRB	12.4

8. **Net credit from the banking system to the government** is defined as the difference between (i) loans, advances, and other government credits from the BRB and all of Burundi's commercial banks, and (ii) government deposits held at those institutions. The relevant scope of government is defined as central government and any other special funds or operations that are part of the budgetary process or have an impact on the government's financial position. Net

credit from the banking system to the government totaled F Bu 71.7 billion at end-June 2004, broken down as follows:

Net credit from the banking system to the government	71.7
Central government	80.8
Loans, advances, and other credits	128.3
BRB	122.4
Commercial banks	5.9
Deposits	47.6
BRB	36.7
Commercial banks	10.8
Other government (net)	-9.1

9. The stock of **external payments arrears** for program monitoring purposes is defined as the end-of-period amount of external debt service due and not paid, including contractual and late interest, for which a clearance agreement is not in place or for which arrears are not reschedulable. Arrears for which a clearance framework has been agreed with the creditor or which are subject to rescheduling or restructuring are not considered arrears for program monitoring purposes. Program arrears would include any debt service due under such agreements which have not been paid. The external payments arrears at end-June 2004 are broken down as follows, showing the actual stock under the heading “technical arrears”:

External payments arrears	Program definition	Technical arrears
Multilateral		
African Development Bank	0	8.6
African Development Fund	0	16.2
International Fund for Agricultural Development	0	0.2
Arab Bank for Economic Development in Africa	0	0.0
Arab League	0	0.0
European Union	0	17.4
European Investment Bank		0.3
International Development Association	0	0.0
OPEC Fund	0	3.4
Bilateral	0	31.7
French Cooperation Agency (AFD)	0	0.0
Japan (FCEOM)	0	0.0
Russia	0	0.0
Abu Dhabi Fund	0	
Kuwait Fund	0	
Saudi Arabia Fund	0	
Libyan Bank	0	0.1
Other creditors		
AD Consultants	0	0.0
Kreditanstalt für Wiederaufbau AMSAR	0	0.6

10. The program includes a ceiling on **new nonconcessional external debts** contracted or guaranteed by the government and the BRB, which precludes the contracting of any such debt.

11. The **stock of short-term external debt**, with a maturity of less than one year, owed by the central government is to remain at zero under the program. Normal import credits are excluded from this ceiling. Loans with an initial maturity, as recorded in the original loan agreement, of more than one year are considered medium term and long term. This performance criterion applies not only to debt, as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted August 24, 2000, but also to commitments contracted or guaranteed for which value has not been received (including leasing). Excluded from this performance criterion are rescheduling arrangements and borrowing from the Fund. The concessional nature of debt will be ascertained on the basis of the commercial interest reference rates (CIRRs), as laid out by the Organization for Economic Cooperation and Development (OECD). A debt is said to be at concessional conditions if, on the date of its initial disbursement, the ratio between the present value of the debt computed on the basis of reference interest rates, on the one hand, and the face value of the debt, on the other hand, is less than 65 percent (equivalent to a grant element of at least 35 percent). As of end-June 2004, the stock of short-term debt outstanding was nil, as was nonconcessional medium- and long-term debt contracted during the first half of the year.

12. A **transfer of dividends from the BRB to the central government** is projected to take place in March 2005, in the amount of F Bu 6.6 billion. Any transfer from the BRB in excess of this amount will be treated as central bank financing (rather than government revenue) and counted against the program's credit from the banking sector ceilings.

13. Receipts from privatization during 2005 are projected to reach F Bu 5.0 billion (equivalent to 0.6 percent of GDP). Any privatization receipts over and above the projected amount will be used to reduce domestic debt.

14. The government's **primary budget balance** is defined as the difference between total government revenue, excluding grants, on the one hand, and noninterest current government expenditure and domestically financed capital expenditure (including through the use of counterpart funds), on the other hand. The primary budget balance for the first six months of 2004 was estimated at F Bu -9.5 billion, broken down as follows:

Primary budget balance	-9.5
Total revenue	69.3
Minus:	
Noninterest current expenditure	66.6
Domestically financed capital expenditure	12.6
Net lending	-0.4

15. The **government's wage bill** is defined as total labor remunerations on a commitments basis for civil servants, contractual employees, and military personnel of the central government,

including all allowances and bonuses. The government's wage bill for the first six months of 2004 totaled F Bu 30.2 billion, broken down as follows:

Government wage bill	30.2
Civilian personnel	18.1
Military personnel	12.1

External financial assistance adjustor

16. The program provides for a symmetrical adjustor for shortfalls or excesses in external nonproject financial assistance that is applied to quantitative targets on the net foreign assets and the net domestic assets of the BRB, and on net bank credit to the government.

17. External financial assistance (measured in terms of U.S. dollars) is defined to include the following: (i) nonproject loans and grants to the budget (including payments made through the multi-donor trust fund managed by the World Bank for current debt service to multilaterals); (ii) debt relief on current maturities; minus (iii) any cash payments for external arrears clearance operations. Disbursements into blocked accounts by donors for the purpose of clearing arrears will not be included as foreign assistance for program monitoring purposes. The assumptions for 2004-05 are shown below.

18. The ceiling or the floor targets will be adjusted to accommodate 100 percent of any deviation from the projected external financial assistance. In case of, respectively, a financing excess (shortfall), the floor on the stock of net foreign assets of the central bank will be adjusted upward (downward), and the ceilings on the stock of net domestic assets of the central bank and on the stock of net credit from the banking system to the government will be adjusted downward (upward). External financial assistance will be converted in terms of Burundi francs on a quarterly basis, using the average official exchange rate.

Burundi. Adjustment of Performance Criteria and Indicative Targets Under the 2004/05 Program
(in millions of U.S. dollars)

	2004			2005			
	June	Sep.	Dec.	March	June	Sept	Dec
	Actual	Actual	Rev. Prog.	Prog.	Prog.	Prog.	Prog.
External nonproject financial assistance (cumulative from beginning of calendar year; in millions of U.S. dollars)	17.3	49.1	93.2	13.1	42.1	61.1	114.4
<i>Of which:</i> Debt relief (current maturities)	3.0	3.8	6.0	1.1	3.8	6.2	8.9
EU	0.0	23.8	43.4	0.0	10.2	10.2	14.1
World Bank (including MDRP)	0.0	0.0	14.8	0.0	0.0	15.0	30.0
AfDB	0.0	0.0	3.2	10.1	10.1	10.1	20.6
France	0.0	3.8	3.8	0.0	3.8	3.8	3.8
Belgium	5.7	5.7	8.3	0.0	2.6	2.6	5.2
Other (Gap)				0.0	9.7	11.3	29.9
Multidonor Trust Fund disbursements	8.6	12.0	13.7	1.9	1.9	1.9	1.9

Sources: Burundi authorities; and Fund staff estimates.

19. External financial assistance will be converted in terms of Burundi francs on a quarterly basis, using the average official exchange rate.

Domestic arrears adjustor

20. The ceilings on the net bank credit to government will be adjusted downward for any accumulation of domestic arrears, as measured by the accumulation of nonexecuted payment orders older than 30 days.

B. Key Program Assumptions

21. The main program assumptions are drawn from the WEO projections of November 2004 as follows:

	2004		2005			
	Jan.-Jun.	Jul.-Dec.	Jan.-Mar.	Jan.-Jun.	Jan.-Sep.	Jan.-Dec.
Average export prices						
Coffee (cents per pound)	76.84	68.84	74.00	73.50	72.67	72.87
Tea (dollars per kg.)	190.64	194.14	195.36	195.02	196.65	198.25
Petroleum (US\$ per barrel)	33.88	43.17	45.00.	44.25	43.50	42.75
End of period						
Dollar per SDR exchange rate	1.48	1.49	1.50	1.50	1.50	1.50
Dollar per euro exchange rate	1.23	1.28	1.30	1.30	1.30	1.30

C. Provision of Information to IMF Staff

22. To facilitate the monitoring of program implementation, the Burundi government will prepare a monthly report within five weeks from the end of each month, which will be sent to IMF staff. In addition, the staff of the monitoring committee (technical bureau of the Secrétariat Permanent de Suivi des Réformes Économiques et Sociales—SP/REFES) will forward to the African Department of the IMF, by facsimile or electronic mail, the data required for program monitoring. These data will include, in particular, on a weekly basis the following:

- A monitoring table (tableau de bord) containing the most recent weekly and monthly data on the main financial indicators;
- A table on the foreign exchange cash flow;
- The balance sheet of the BRB (situation hebdomadaire).

23. The following data are to be provided on a monthly basis:

- The monetary survey, including breakdown of the central bank and of commercial banks;
- The financial position of the government vis-à-vis the banking system;

- A detailed breakdown of government revenue;
- A detailed breakdown of government expenditure on a commitment basis;
- A detailed breakdown of the government wage bill on a commitment basis;
- Detailed information on government social spending, in particular on the health and education sectors;
- A detailed breakdown of the servicing of domestic and external public debt, including amounts due and paid, in interest and principal, as well as the detail by creditor and any accumulation of arrears on domestic or external debt;
- A detailed breakdown of the stock of domestic payments arrears and cumulative flows from January 1, 2004; the accumulation of new arrears is defined as the difference between commitments and actual payments (on a cash basis, as reported in the cash statement summary—Reddition des comptes);
- The amount of new debts contracted or guaranteed by the government, including detailed information on its conditions (such as currency denomination, interest rate, grace period, maturity);
- Actual disbursements of nonproject financial assistance, including new loans and debt relief granted by Burundi's external creditors;
- The weekly balance sheet of the BRB and the outcome of weekly foreign exchange auctions, including the allocated amounts and exchange rate levels, as well as the level of buying and selling exchange rates used by commercial banks and those observed on the parallel market;
- Indicators and other statistical data to allow an evaluation of macroeconomic developments, such as the consumer price index, indices of manufacturing output, merchandise imports and exports (volume and value), with a breakdown by main categories; and
- An update on the implementation of structural measures planned under the program, as summarized in Table 3 of the MEFP.

24. The SP/REFES will also provide the African Department of the IMF with any information that is deemed necessary to ensure an effective monitoring of the program.

Burundi: Relations with the Fund
(As of November 30, 2004)

I. Membership Status: Joined 09/28/63; Article XIV

II. General Resources Account:	<u>SDR</u> <u>million</u>	<u>% Quota</u>
Quota	77.00	100.00
Fund holdings of currency	76.64	99.53
Reserve position in Fund	0.36	0.47

III. SDR Department:	<u>SDR</u> <u>million</u>	<u>% Allocation</u>
Net cumulative allocation	13.70	100.00
Holdings	0.10	0.69

IV. Outstanding Purchases and Loans:	<u>SDR</u> <u>million</u>	<u>% Quota</u>
PRGF Arrangements	26.40	34.29

V. Latest Financial Arrangements:

<u>Type</u>	<u>Approval date</u>	<u>Expiration date</u>	<u>Amount approved (SDR million)</u>	<u>Amount drawn (SDR million)</u>
PRGF	1/23/04	1/22/07	69.30	26.40
PRGF	11/13/91	11/12/94	42.70	17.21
Structural Adjustment Facility (SAF)	8/8/86	8/7/89	29.89	29.89

VI. Projected Payments to the Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	<u>2004</u>	Forthcoming <u>2005</u>	<u>2006</u>	<u>2007</u>
Principal	0.00	0.00	0.00	0.00
Charges/interest	<u>0.07</u>	<u>0.41</u>	<u>0.41</u>	<u>0.41</u>
Total	0.07	0.41	0.41	0.41

VII. Implementation of HIPC Initiative:

Not applicable

VIII. Safeguards Assessments:

Under the Fund's safeguards assessment policy, the Banque de la République du Burundi (BRB) is subject to a full safeguards assessment with respect to the PRGF arrangement approved on January 23, 2004. However, in view of the constrained administrative and technical capacity in Burundi caused by prolonged civil conflict, a two-step approach to completing the safeguards assessment has been adopted. The first step, which was successfully completed on June 22, 2004, involved a targeted assessment of the areas considered critical to preventing the possibility of misreporting and safeguarding IMF resources, i.e., the BRB's external audit and financial reporting mechanisms and the system of internal controls. The second step, which will comprise a follow-up assessment after the most important safeguards recommendations are in place, will evaluate the BRB's legal framework and internal audit mechanism and, additionally, review the effectiveness of the measures implemented as a result of the first stage of the assessment.

IX. Exchange Arrangements

Burundi maintains a managed float exchange regime. In July 2000, the authorities began reversing the heavy restrictions put in place during the 1993-96 civil hostilities and embargo period by introducing a system of weekly foreign exchange auctions. In 2002, in the context of a Fund-supported program, the central bank eliminated the positive list of imports eligible for BRB foreign exchange, implemented a single, competitive settlement exchange rate for each weekly auction, and reduced the full surrender requirement for coffee, tea, and cotton exports to 70 percent. In 2003, the central bank lifted all remaining exchange restrictions on current transactions and delegated authority to the commercial banks to approve standard transactions. In early 2004, the surrender requirement was lowered further to 50 percent. The central bank admitted foreign exchange bureaus to the weekly auctions. Burundi has accumulated sizeable external payments arrears to various bilateral and multilateral creditors. Burundi avails itself of the transitional arrangements of Article XIV.

X. Article IV Consultation

Burundi is on the 24-month cycle. The 2003 Article IV consultation discussions were conducted in Addis Ababa and Bujumbura during the period October 14-29, 2003. The staff report was discussed by the Executive Board on January 23, 2004, along with the consideration of the request for three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). On that occasion, Executive Directors welcomed the progress made in advancing the peace process since the Arusha Agreement in 2000 and commended the authorities for the strong implementation of their post-conflict economic program in 2003. They noted that Burundi still faced formidable challenges, particularly with regard to reducing the heavy external debt burden, absorbing a large number of refugees and internally displaced persons, and demobilizing

combatants. They emphasized the critical importance of coffee sector reform. Directors considered that, provided there was continued satisfactory track record of policy implementation, Burundi's decision point under the Initiative for Heavily Indebted Poor Countries could be reached by the time of the second review under the PRGF.

XI. Technical Assistance

2004 (Nov.)	STA multisector mission
2004 (Nov.)	MFD multitopic mission
2003 (Oct.)	Resident MFD consultant on monetary policy management (jointly with Rwanda)
2003 (April)	Two (of four) visits by MFD expert on monetary policy management
2003 (Feb.)	Visit by FAD expert on tax administration
2002 (Nov.)	MFD mission on liquidity management and foreign exchange operations
2002	Participation of MFD experts on Article IV/UFR mission
2001–02:	Three FAD visits by a tax administration expert, in preparation for setting up large taxpayers' unit
2000	STA mission on monetary and banking statistics
2000	FAD mission on tax and customs administration
1998	MFD mission on foreign exchange auctions

XII. Resident Representative

None.

Burundi: Relations with the World Bank Group (As of end-November 2004)

A. Partnership in Burundi's Development Strategy

1. As Burundi recovers from its long conflict, the transitional government is developing its strategy for inclusive development. An Interim Poverty Reduction Strategy Paper (I-PRSP) has been completed through participatory methods and has become a core document in the national strategy. The Executive Directors of the World Bank and the Fund conducted a Joint Staff Assessment and endorsed the I-PRSP in January 2004. The government is using the PRSP process to improve coordination of development efforts in the country, including donor-supported activities. Furthermore, the 2003 and 2004 budgets as well as the 2005 budget are being adopted in line with the I-PRSP.

2. The Fund is supporting this strategy through a PRGF, and is taking the lead in addressing fiscal imbalances, and the Fund and the Bank share the lead on the policy dialogue on macroeconomic stability and economic growth. The Bank leads the policy dialogue on post-conflict rehabilitation and reintegration, education, health and social policy reforms, privatization, the environment for employment creation (particularly in rural areas), and sustainable infrastructure.

B. IMF-World Bank Collaboration in Specific Areas

3. Common objectives and the development of post-conflict instruments have led to increased collaboration between the Fund and the Bank in recent years. The Bank and Fund teams have been closely coordinating their assistance strategies and policy advice and the implementation of the I-PRSP. There is also close coordination and good cooperation in the determination of structural conditionalities, in particular as regards crucial reforms for the coffee sector. The Bank is leading the policy dialogue on key structural aspects of the reform program both through dialogue and technical assistance. The Fund is leading the policy dialogue on macroeconomic and financial issues, in particular fiscal, monetary and exchange regime policies. Both institutions are providing significant technical assistance in their respective areas. The Fund and the Bank have both contributed to the Diagnostic Study for the Integrated Trade Framework—a review of the policy, regulatory and institutional framework—with the objective of promoting employment-generating trade. Collaboration in 2005 will be intensified in the context of the preparation of Burundi's full-PRSP (May 2005) and participation in the enhanced HIPC Initiative, with the decision point expected to be reached by mid-2005.

C. World Bank Group Strategy

4. The Bank's current (2002-2004) Transitional Support Strategy (TSS) supports the rehabilitation of Burundi's economy, particularly through economic reforms for sustained economic recovery, growth and poverty reduction. This includes the improvement of public service delivery and basic social services, the deepening of institutional and structural reforms, and the establishment of a track record for early access to debt relief under the Enhanced HIPC

Initiative. Support for affected populations during the progress towards sustainable peace, and improving the delivery of essential social services would enhance the reintegration of refugees into productive employment. This would eventually boost economic recovery and growth and help reduce the incidence of poverty. The new TSS for 2004-06, which draws upon this experience, is under preparation, for Board consideration in March 2005. The themes of the new TSS include: (a) security, social stability and service delivery; (b) debt relief, economic growth and diversification; and (c) governance and capacity building for public institutions. It is expected that progress will be made during this period towards the preparation of a full PRSP, which will provide the basis for a Country Assistance Strategy.

5. An Economic Rehabilitation Credit (ERC), amounting to US\$54 million, of which US\$20 million was disbursed during 2002 and US\$20 million in April 2003 - (the third tranche will be released by end-December 2004) - is intended to support economic recovery through BOP support which finances eligible private sector imports based on a negative list; and the counterpart funds generated from ERC foreign exchange auctions by the Central Bank (BRB) will be used to finance specific development programs in the national budget. The Bank also manages a trust fund for arrears stabilization and debt service to multilateral development banks (particularly AfDB). Besides the strong partnership with the Fund, the Bank is collaborating with a number of donors, including with the European Union. A new adjustment operation is currently under preparation.

6. The current IDA project portfolio (see table below) consists of 10 projects for a total commitment of US\$337 million and an undisbursed amount of about US\$230 million. The portfolio also includes a number of grants, which are not included in this table.

Active Portfolio in Burundi — IDA Financing

(As of end-November 2004)

(In millions of U.S. dollars, unless otherwise indicated)

Project Name	Approval Fiscal Year	Closing Date	Net Commitment	Of which Grants	Un-disbursed	Disbursed in Fiscal Year
Health & Population II	1995	12/31/04	30.00	9.50	10.70	3.90
BURSAP II	2000	12/31/05	24.20	14.00	11.50	6.60
Regional Trade Facilitation	2001	06/30/11	7.50	0.00	1.70	1.80
Public Works and Employment Creation	2001	12/31/06	40.00	0.00	18.70	6.55
HIV/AIDS and Orphans	2002	12/31/06	36.00	0.00	27.70	1.90
ERC	2003	12/31/04	54.00	0.00	14.77	40.00
Economic Management Support	2004	07/31/09	26.00	0.00	25.69	0.85
Road Sector Development	2004	12/31/09	51.40	0.00	51.40	0.00
Demobilization and Reintegration	2004	12/31/08	33.00	33.00	33.00	0.00
Agriculture Rehabilitation and Sustainable Land Management	2005	10/31/10	35.00	35.00	35.00	0.00

Nonlending activities

7. IDA assistance also emphasizes *nonlending activities and advisory services*, including those under ongoing operations, plus through trust funds and grants, to improve understanding of the socioeconomic context, rebuild the knowledge base to support the policy dialogue, and design effective poverty reduction strategies. Ongoing advisory services and economic and sector work include: strengthening public expenditure management; providing support to the PRSP process, specifically the consultation and participatory diagnostic processes and; a study on sources of growth to support the overall strategy. New activities will include: a post-conflict social sector assessment, an economic study/poverty assessment, and a Country Procurement Assessment (CPAR).

TSS update

8. The new TSS will cover a 24-month period, spanning FY05, FY06, and early-FY07. IDA financing for those years will be discussed within the context of the new TSS. It is expected that progress will be made during this period towards the preparation of a full Poverty Reduction Strategy Paper, which will provide the basis for a Country Assistance Strategy.

IFC

9. **The International Finance Corporation** holds a US\$1 million equity portion in Verreries du Burundi, which is not sellable owing to the poor performance of this public enterprise.

MIGA

10. **The MIGA** portfolio in Burundi includes two active applications for a total investment of US\$6.5 million.

Prepared by World Bank staff. Questions may be addressed to: Mr. Gerard Byam, Acting Country Director at 458-7237; or Brendan Horton, Lead Economist at 473-5587; or Achille Toto Same at 473-1911.

Burundi: Relations with the African Development Bank Group
(As of October 30, 2004)

Burundi has been a member of the AfDB Group since its foundation in 1964. The AfDB's grant and loan operations with the country were interrupted by the outbreak of civil strife in 1993. Total grants and loans disbursed before end-1993 amount to SDR 64.7 million.

Over the last decade, Burundi has accumulated arrears to the AfDB, totaling about US\$31 million at end 2003. Payments on current debt service due were resumed during 2003. In June 2003, Burundi reached an understanding with the AfDB on the clearance of arrears and the government paid 20 percent of the outstanding total in the first quarter of 2004. On July 19, 2004 the AfDB Boards approved general policy guidelines to assist post-conflict countries to clear their arrears and created a facility, the PCCF, initially funded with about SDR 100 million in AfDB funds, to provide financial assistance to qualifying post-conflict countries. The policy guidelines call for a three-way burden sharing formula among the country, donors and the PCCF. On October 27, 2004, the AfDB Boards endorsed a specific arrears clearance proposal for Burundi whereby the balance of arrears will be settled with the help of donors and the PCCF before the decision point under the enhanced HIPC Initiative, expected in the first half of 2005. In Burundi's case, the residual arrears will be cleared in equal parts by the PCCF (SDR 8 million) and donors SDR 8 million (the EU; euro 7.6 million, and France euro 2 million), respectively.

The AfDB staff is preparing to resume lending operations (under its FAD 9 allocation) following the lifting of sanctions in October 2004. On July 7, 2004, the Bank Group approved a grant of SDR 2.13 million to finance training of civil servants and procurement of equipment for institutions in charge of economic management and the civil society. A structural adjustment credit totally SDR 6.72 million, in two tranches, accompanied by a further grant of SDR 1.5 million for institutional support, was sent to the Board for approval in late 2004. A multi-sector project, totaling SDR 9.8 million, is also under preparation for approval in late 2004. Negotiations on the FAD 10 allocation and funding are progressing. It is expected that Burundi and other post-conflict nations would see sizeable increases in their allocations.

Table: AfDB Operations in Burundi

	Outstanding loans	Past-due obligations
	(In millions of SDRs)	
African Development Bank	2.9	5.5
African Development Fund	145.2	10.3
Nigerian Trust Fund	0.4	0.4
Total	148.5	16.0

Burundi: Millennium Development Goals

	1990	1995	2001	2002	2015 Target
Goal 1. Eradicate extreme poverty and hunger					
Target 1: Halve between 1990 and 2015, the proportion of people whose income is less than one dollar a day.					
1. Population below US\$1 a day (percent)	...	...	^{1/} 58.4	...	...
2. Poverty gap ratio at US\$ 1 a day (percent)	...	...	...	...	...
3. Share of income or consumption held by poorest 20 percent (percent)	^{2/} 7.9	...	^{1/} 5.1	...	...
Target 2: Halve, between 1990 and 2015, the proportion of people suffering hunger					
4. Prevalence of child malnutrition (percent of children under 5)	...	...	45.1	...	...
5. Population below minimum level of dietary energy consumption (percent)	49.0	64.0	70.0	...	24.5
Goal 2. Achieve universal primary education					
Target 3: Ensure that, by 2015, children will be able to complete a full course of primary schooling					
6. Net primary enrollment ratio (percent of relevant age group)	52.0	29.5	53.4	...	100.0
7. Percentage of cohort reaching grade 5	61.8	...	64.0	...	100.0
8. Youth literacy rate (percent age 15-24)	51.6	57.9	65.1	66.1	100.0
Goal 3. Promote gender equality and empower women					
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education by 2015					
9. Ratio of girls to boys in primary and secondary education (percent)	82.0	...	79.4	...	...
10. Ratio of young literate females to males (percent ages 15-24)	76.7	86.0	95.6	96.9	...
11. Share of women employed in the nonagricultural sector (percent)	...	...	...	...	...
12. Proportion of seats held by women in the national parliament (percent)	...	11.3	14.4	19.6	...
Goal 4. Reduce child mortality					
Target 5: reduce by two-thirds between 1990 and 2015, the under-five mortality rate					
13. Under-five mortality rate (per 1,000)	184.0	194.0	204.0	208.0	61.3
14. Infant mortality rate (per 1,000 live births)	111.0	116.0	121.0	123.0	...
15. Immunization against measles (percent of children under 12-months)	74.0	80.0	75.0	75.0	...
Goal 5. Improve maternal health					
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.					
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	1,000.0	...	...
17. Proportion of births attended by skilled health personnel (% of total)	...	...	25.2	...	...
Goal 6. Combat HIV/AIDS, malaria and other diseases					
Target 7: Halt by 2015, and begin to reverse, the spread of HIV/AIDS					
18. HIV prevalence among females (percent ages 15-24)	...	...	11.0	...	...
19. Contraceptive prevalence rate (percent of women ages 15-49)	...	...	...	...	...
20. Number of children orphaned by HIV/AIDS	...	...	240,000	...	...
Target 8: Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases					
21. Prevalence of death associated with malaria	...	...	...	...	...
22. Share of population in malaria risk areas using effective prevention and treatment	...	...	...	...	...
23. Incidence of tuberculosis (per 100,000 people)	...	...	406.2	...	...
24. Tuberculosis cases detected under DOTS (percent)	...	16.0	30.0	...	...

Burundi: Millennium Development Goals (concluded)

	1990	1995	2001	2002	2015 Target
Goal 7. Ensure environmental sustainability					
Target 9: Integrate the principles of sustainable development into policies and programs. Reverse the loss of environmental resources					
25. Forest area (percent of total land area)	9.4	...	3.7	...	...
26. Nationally protected areas (percent of total land area)	...	5.5	5.7	5.7	...
27. GDP per unit of energy use (PPP \$ per kg oil equivalent)	...	...	...	...	...
28. CO2 emissions (metric tons per capita)	0.0	0.0	0.0	...	...
29. Proportion of population using solid fuels					
Target 10: Halve by 2015 proportion of people without access to safe drinking water					
30. Access to improved water source (percent of population)	69.0	...	78.0	...	84.5
Target 11: Achieve by 2020 significant improvement for at least 100 million slum dwellers worldwide					
31. Access to improved sanitation (percent of population)	87.0	...	88.0	...	...
32. Access to secure tenure (percent of population)	...	...	...	...	...
Goal 8. Develop a Global Partnership for Development 3/					
Target 16: Develop and implement strategies for productive work for youth.					
45. Unemployment rate of population ages 15-24 (total)	...	...	...	...	...
Female	...	...	...	...	...
Male	...	...	...	...	...
Target 17: Provide access to affordable essential drugs					
46. Proportion of population with access to affordable essential drugs	...	...	...	...	...
Target 18: Make available new technologies, especially information and communications					
47. Fixed line and mobile telephones (per 1,000 people)	1.5	2.9	7.4	10.6	...
48. Personal computers (per 1,000 people)	...	...	0.7	0.7	...

Sources: World Bank; and Fund staff estimates.

1/ Survey data for 1998

2/ Survey data for 1992

3/ Targets 12-15 and indicators 33-44 are excluded because they can not be measured on a country specific basis. These are related to official development assistance, market access, and the HIPC initiative.

Statement by the IMF Staff Representative
January 19, 2005

The following is information received since the staff report was issued, on the prior actions, important structural measures, and macroeconomic developments. The thrust of the staff appraisal remains unchanged.

1. All three prior actions have been implemented

- The 2005 budget was approved by parliament and signed by the President on December 31, 2004, in line with the program.
- The new budget and accounting charter was also approved on December 31, 2004 and is entered into effect with the 2005 budget.
- The law on the status of magistrates of the audit court was sent to parliament in mid-December 2004. In late 2004, the audit court reviewed the 2005 budget proposals. Preparations to initiate the audit of the 2004 government accounts by April 2005 have begun.

2. Good progress has been made on the structural side

- Regarding the coffee sector, the Presidential decree liberalizing private investment at all levels of the supply chain was signed into effect on January 14, 2005.
- With regard to the foreign exchange regime, on January 10, 2005, the remaining export surrender requirement (50 percent of exports of coffee, tea, and cotton) was abolished, considerably in advance of the program target (a structural performance criterion for end-March 2005).

3. Macroeconomic developments have been mixed

- Preliminary data indicate that CPI inflation in December 2004 was above target at about 10½ percent (year-on-year). This in part reflects a sharp rise in the prices of basic food items in recent months subsequent to a severe drought in two Northern provinces and continued high petroleum prices.
- Since the liberalization of the exchange regime to a market-determined system in mid-December 2004, the exchange rate has depreciated some 3½ percent against the U.S. dollar, and now appears to have stabilized in value.
- Government revenue has performed very strongly in the fourth quarter and may exceed program expectations for 2004 by close to 1 percent of GDP.



Press Release No. 05/9
FOR IMMEDIATE RELEASE
January 19, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes First Review Under Burundi's PRGF Arrangement and Approves US\$10.9 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Burundi's economic performance under an SDR 69.3 million (about US\$105.6 million) Poverty Reduction and Growth Facility (PRGF) arrangement ([see Press Release No. 04/13](#)), and approved the disbursement of an amount equivalent to SDR 7.15 million (about US\$10.9 million), which will bring the total disbursements under the PRGF arrangement to SDR 33.55 million (about US\$51.1 million). The Executive Board of the IMF approved a three-year arrangement under the PRGF for Burundi on January 23, 2004 to support the country's economic reform program through January 2007.

In completing the first review, the Executive Board granted Burundi's request for waivers of nonobservance of performance criterion pertaining to external payments arrears, the establishment of a new auditing court; and the adoption of weekly liquidation auctions.

Following the Executive Board's discussion on Burundi's economic performance, Agustín Carstens, Deputy Managing Director and Acting Chair, stated:

“Burundi has made a good start in implementing its PRGF-supported program, against the backdrop of a difficult political environment. Encouragingly, the demobilization process has begun and the security situation has improved. Macroeconomic developments in 2004 were broadly on track, with somewhat higher-than-expected real growth, but overall program performance was mixed owing to fiscal slippages and delays in implementing structural reforms. Notwithstanding these broadly positive developments, Burundi faces enormous challenges, including the need to complete the political transition and the demobilization of armed combatants, to secure debt relief, and to address widespread poverty and work to meet the Millennium Development Goals.

“Fiscal slippages in 2004 reflected the adverse fiscal effects of the surge in petroleum prices and higher spending associated with the peace process, but also the need to cover higher coffee sector losses from budgetary resources--underscoring the urgency of implementing the coffee reform strategy. The increase in donor-supported project spending is welcome.

“The 2005 budget envisages a reduction in the primary fiscal deficit and a further increase in social spending. Savings from reduced military spending are to be redirected to urgent social needs. Appropriate and timely donor support will be vital to ensure that this effort moves ahead without destabilizing public finances. Measures are also being taken to strengthen the management of public finances, notably through a new budget and accounts code and improved wage bill management.

“The Bank of the Republic of Burundi is strengthening its monetary instruments and its supervision of the banking sector, building on the improvements made in 2004. Reflecting recent reform steps, the differential between the official and parallel exchange rates has fallen to historic lows. In mid-January 2005, the remaining foreign exchange surrender requirement was eliminated. The authorities are proceeding with further liberalization of the exchange and trade systems.

“Based on a preliminary debt sustainability analysis, jointly undertaken by IMF and World Bank staff, Burundi’s external debt burden at end-2003 is unsustainable after traditional debt relief. It is likewise expected that the country’s debt situation will be shown to have been unsustainable, after traditional debt relief, at end-2004. On this basis, Burundi is likely to qualify for assistance under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative and could reach its HIPC decision point by mid-2005, provided its macroeconomic program, supported by the PRGF arrangement, remains on track as evidenced by completion of the second program review. Given Burundi’s heavy debt burden, it is important that external financial assistance be in the form of grants and/or highly concessional loans,” Mr. Carstens said.

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a PRSP. This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5 ½-year grace period on principal payments.

**Statement by Peter J. Ngumbullu, Executive Director for Burundi and
Dieudonne Nintunze, Advisor to Executive Director
January 19, 2005**

Introduction

1. On behalf of the Burundian authorities, we would like to express their gratitude to the staff, management and the Executive Board for their invaluable advice and continued support. They are also appreciative for a balanced staff report on the First Review Under the PRGF arrangement and the constructive policy recommendations. They are also thankful for the Preliminary HIPC Document which adequately highlights Burundi's unsustainable debt burden, and the urgent need for debt relief. They regard the discussions held with staff as very helpful in their efforts to consolidate peace and to address the challenges facing the economy. The authorities have reiterated their firm commitment to the successful implementation of all reforms and measures agreed under their economic program.

2. Burundi has made significant progress in its continued effort to consolidate peace and national reconciliation, despite a difficult environment. Major progress achieved in the implementation of the peace agreement include the reform of the defense and security sector, formulation of a post-transition constitution, and creation of an independent national electoral commission, as well as the establishment of a timetable for elections through April 2005. Progress on the reform of defense and security sector include the adoption in late 2004 of laws creating an integrated national defense force and a new national police, and regulating the process of cantonment, disarmament, demobilization and reintegration of ex-combatants into the civil society. In this connection, the cantonment of 22,000 former rebel combatants was completed by end-October 2004, and disarmament and demobilization of ex-combatants has accelerated since November 2004 under the supervision of the peacekeeping forces of the United Nations mission in Burundi (ONUB) and with the support of the World Bank's Multi-Country Demobilization and Reinsertion Program (MDRP) for the Great-Lakes region, and bilateral donors.

3. Also, despite limited resources, the independent National Commission in charge of the War Victims Rehabilitation (the CNRS) has formulated an action plan and implemented actions for resettlement and reintegration of more than 300,000 refugees and internally displaced persons. The National Electoral Commission is undertaking the necessary preparatory work in collaboration with all partners, to enable referendum on the new constitution and national elections to be held by May 2005. The improvements in political and security situation have helped the authorities to make progress in the implementation of the financial and structural reform program supported by the PRGF arrangement.

Recent economic developments and performance under the program

4. The overall economic performance in 2004 has been broadly on track with program objectives, notwithstanding some fiscal slippages. The economic growth is expected to be above the program target of 5 percent in 2004, benefiting from improvements in the security

situation and larger-than-expected recovery of coffee production, as well as reconstruction activities in infrastructure. After reaching 10.7 percent in 2003, inflation declined to an average of 7 percent during the first eleven months of 2004 and is estimated to remain at this level for the whole of 2004. The downward trend of inflation is, however, lower than targeted, in spite of a pick-up in the third quarter, because of the rise in international oil prices. The sharp increase in petroleum prices is also impacting on the external and fiscal accounts. Burundi's currency has been stable vis-à-vis the US dollar. The exchange rate spread between the official and the parallel market narrowed to 2-3 percent at the end of 2004, from 15 percent in 2003, reflecting the authority's policy effort, as well as a gradual increase in foreign aid inflows.

5. The primary fiscal deficit was higher than programmed in the first half of the year and at end-September 2004. The budget execution suffered from a shortfall in revenue from taxes on international trade, reflecting lower than envisaged tax receipts from oil products, as well as lower than expected profit transfers from the BRB. Public expenditure was higher than programmed at end-September, due to unexpected high cost of the peace process and other post-conflict needs. These include costs of reintegration of displaced persons and refugees, and costs of inclusion of former rebel groups in government institutions and in the national army. However, these high demands increased pressure on the budget, as disbursement of the promised international support was lower than projected.

6. Notwithstanding these slippages, the authorities remain strongly committed to keeping the fiscal program on track. They implemented measures aimed at tightening control on budget operations, improving efficiency and reducing distortions in tax administration. In this respect, the larger-taxpayers unit has been strengthened and the transaction tax has been extended to all domestic transactions. Customs operations have been improved through the introduction of the Sydonia customs management system, and improvement of bonded warehousing as well as pre-inspection of imports. These improvements in the customs operations have offset loss of revenue impact arising from removal of customs duties for goods originating from countries in COMESA. A revised budget has been agreed for 2004 with staff and the authorities issued a decree after the approval by Parliament in September 2004. The authorities implemented additional measures aimed at improving revenue collection, including extension of the import service charge to non-diplomatic imports. They also provided for the much needed hiring of 2,300 new teachers and 500 medical personnel to address the existing shortages and to improve the delivery of social services, with a view of meeting PRSP's objectives.

7. The authorities made substantial efforts to normalize relations with external creditors. They negotiated the first Paris Club rescheduling in March 2004, and completed the clearance of the remaining multilateral arrears.

8. The unexpected expenditure and delays in budget support have resulted in increased pressure on monetary policy, but the Bank of the Republic of Burundi (BRB) remained committed to maintaining a tight monetary stance to support the program's inflation objective. It has implemented various measures aimed at enhancing liquidity management, including the introduction of marginal refinancing window at a penalty rate for credit to

banks, as well as new rules governing the reserve requirements. It has established an action plan for the introduction of weekly liquidity auctions with the support of MFD Technical Assistance. The prudential compliance for the banking sector has been strengthened. The minimum capital has more than tripled, but two insolvent financial institutions have been closed as a result of failure to meet this compliance requirement. All remaining banks continue to meet prudential requirements in terms of liquidity and solvency, as well as in terms of structure of assets and liabilities.

9. Progress has been made in liberalizing the exchange system, resulting in a significant narrowing of the spread between official and parallel exchange rate. Other measures taken have included admission of foreign exchange bureaus to the BRB's weekly foreign exchange auctions, reduction in foreign exchange surrender requirements, abolition of the mandatory nature of the BRB's auction reference price for commercial transactions, as well as changes in the determination of the official exchange rate from weekly auction to the daily average market rate.

10. The authorities acknowledge that progress in the implementation in some areas of structural reforms have been slower than targeted, due to the complex political environment and weak administrative capacity. However, they have taken courageous measures aimed at improving transparency and governance in economic and financial management, and completion of new steps in reforming the key productive sectors. In this regard, the Cabinet adopted a new budget and accounting charter in late 2004, and the BRB has appointed an external audit firm which started carrying out its work in November 2004. In addition, following the promulgation of the basic law on the establishment of the Auditing Court, magistrates were appointed in June 2004, with the internal regulations being put in place in October 2004. The law defining the magistrate's legal status was submitted to Parliament in late 2004, and an action plan approved in October 2004 by Cabinet and is being implemented. This will enable the Court to start auditing the 2004 budget accounts by April 2005. The reform strategy for the coffee sector was also approved in October 2004 and its action plan is being implemented with the support of the World Bank and the European Union. In this connection, the coffee auction system conducted by the Office in charge of Coffee sector operations (OCIBU) has been reformed to include representatives of all stakeholders; and a decree liberalizing investment, marketing and export in the sector has been adopted by Cabinet.

Medium-term outlook and the program for 2005

11. Notwithstanding the encouraging progress made so far in the implementation of the program, the Burundian authorities are faced with enormous challenges. These include the need to consolidate macroeconomic stability, deal with the emerging and very sensitive post-conflict needs, diversify the sources of growth, address the widespread deep poverty situation, and make progress towards achieving the Millennium Development Goals (MDGs). To this end, they are committed to increase agricultural productivity, promote rural development opportunities, diversify exports, improve efficiency in the delivery of social services, extend coverage of the country's essential public infrastructure, speed up

implementation of the structural reform agenda and develop the private sector. The 2005 program objectives aim at sustaining economic growth at 5 percent, reducing inflation to 5.5 percent, reducing by 1 percent of GDP the primary deficit from its level of 2004, and strengthening international reserves.

Fiscal policy issues

12. The 2005 budget which was approved by Parliament in December 2004 aims at maintaining macroeconomic stability, while securing government's spending priorities. The ratio of revenue to GDP is expected to remain at 19 percent as in 2004, social sector spending would increase to 7 percent of GDP, while military spending would decline by about 0.5 percent of GDP. Overall, primary spending would be reduced by 1 percent of GDP. In support of these fiscal program objectives, tax policy measures will include the lowering and simplification of import tariffs, in order to reduce smuggling, simplify tax administration and boost trade. Other revenue measures include the strengthening of tax and customs administration to containing customs duty exemptions and reduce tax evasion, extend income tax payments to Burundians employed by international agencies, and the implementation of preparatory measures required for the introduction of a VAT system as soon as possible.

13. The Burundian authorities are also committed to improve the management of public finances, with technical and financial support from donors, including the World Bank through the Economic Management Support Credit (PAGE), the European Union, the African Development Bank and bilateral donors. They also intend to enhance the civil service payroll management and improve expenditure control by implementing the newly adopted public accounting and budgetary code.

Monetary and exchange rate policy issues

14. Monetary policy in 2005 will continue to support the low inflation objective. The BRB, supported by IMF technical assistance, will speed up implementation of the preparatory work required to introduce weekly liquidity auctions, and move to a more effective market-determined liquidity management system. To this end, the BRB will undertake beginning January 2005 actions to enhance its liquidity forecasting capabilities and will standardize treasury bills and make them tradable, to support a more active monetary policy.

15. The BRB strengthened the minimum capital required for banks during 2004 and the financial sector remains sound overall. The monetary authorities will continue to enhance bank supervision, tighten the existing prudential requirements and gradually improve towards international standards. In addition, the BRB is taking measures to improve governance and transparency of its operations and following the multi-year contract signed for external audit last year, the appointed firm will carry out its work, by auditing the 2004 accounts. The BRB will also pursue the exchange liberalization policy to consolidate the progress made in 2004, with a view of establishing a more efficient market for foreign exchange.

Structural reforms

16. The authorities are committed to step up implementation of the structural reform agenda to improve the private sector environment and governance. In this regard, in addition to the ongoing reforms to improve public financial management, and liberalize the exchange regime, the authorities are determined to implement the action plan for the reform of coffee sector to enhance efficiency in the sector. The reform strategy includes liberalization of investment, restructuring of the OCIBU into a regulatory and support agency, and the privatization of the processing infrastructure. The tea and the sugar sectors will also be liberalized. With regard to governance, the Auditing Court will carry out all preparatory work required for auditing the 2004 public accounts.

Enhanced Initiative for Heavily Indebted Poor Countries (HIPC) Preliminary Document

17. Burundi has made tremendous efforts to maintain relations with its creditors. It has always serviced in a timely manner its obligations to the Fund and the World Bank. Nonetheless, as shown by the preliminary Debt Sustainability Analysis prepared by IMF and IDA staffs, Burundi's external debt service burden remains unsustainably high.

18. The Burundian authorities are implementing the I-PRSP prepared through a consultative process which provides for a long-term vision for the country's development, focusing on promotion of sustainable and equitable economic growth and poverty reduction, with priority given to critical strategic themes, namely: peace and democratic governance, reintegration of conflict victims and disadvantaged groups into the economy, private sector and human capital development. Despite these daunting challenges and tight program that the authorities are facing, they are confident that they will manage the situation and achieve the program targets. The full PRSP is being finalized for adoption in May this year. The authorities therefore request that, given the unsustainable high debt situation, all collaborative efforts should be taken with development partners to enable Burundi reach the Decision Point for debt reduction not later than mid-2005, following completion of the second program review, as Burundi has met all the eligibility criteria for enhanced HIPC initiative; and the authorities are committed to take all necessary measures to remain on track with the program and reach the HIPC completion point within the required minimum period.

Conclusion

19. The Burundian authorities have made considerable progress in accelerating implementation of the peace and national reconciliation agreement. They remain fully committed to speeding up required reforms and actions in the political transition agenda, with a view of establishing a sustainable political system and necessary conditions for economic growth and poverty reduction. However, the challenges ahead are daunting and require continued support and greater commitment by the international community to see the peace process safely through. More than half of population live in extreme poverty situation and the

MDGs will not be achieved if the economic growth is not accelerated. The Burundian authorities are concerned that, in such difficult environment, failure to proceed expeditiously with military demobilisation could in turn destabilize the fiscal and macroeconomic situation.

20. Notwithstanding the enormous challenges they continue to face, the Burundian authorities' commitment to successful implementation of their economic program is strong. Most of the performance criteria were observed, the two structural benchmarks were fully met and all the prior actions for the completion of the first review of the PRGF arrangement have been completed on time. As regard to the delays in observance of the performance criteria on the establishment of the Audit Court, introduction of liquidity auctions, as well as to the deviation from the end-June 2004 ceiling on external arrears, they have taken important steps towards corrective actions and they request the Board to grant waivers. Burundi's external debt service burden remains unsustainably high and the authorities would like to request to reach the HIPC Decision Point as soon as possible, without delay. They continue to count on the understanding and support of the Fund and the international community to enable them achieve the intended objectives.